

Exhibit 1

REPORTER'S RECORD

VOLUME 1 OF 1 VOLUME

COURT CAUSE NO. 2011-67305

FEDERAL DEPOSIT INSURANCE) IN THE DISTRICT COURT
CORPORATION AS RECEIVER)
FOR FRANKLIN BANK, S.S.B.)
Plaintiff,)
VS.) HARRIS COUNTY, TEXAS
MORGAN STANLEY & COMPANY, LLC,)
f/k/a MORGAN STANLEY & CO. INC.)
Defendant.) 151ST JUDICIAL DISTRICT

MOTION IN LIMINE

On the 1st day of June, 2015, the
following proceedings came on to be heard in the
above-entitled and numbered cause before the Honorable
Mike Engelhart, Judge Presiding, held in Houston,
Harris County, Texas.

Proceedings reported by computer-aided
transcription/stenograph machine.

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P R O C E E D I N G S

06/01/2015 (Open court)

MR. GRAIS: Your Honor, with the Court's permission, I would like to address two of the motions together: The motion addressed to Franklin's specific knowledge and the motion addressed to the admissibility of newspaper articles and complaints against third parties. Because Morgan Stanley's position on these two motions rests on three fundamental misconceptions of law that are common to its opposition of both motions.

The first is Morgan Stanley's overly broad concept of materiality. Morgan Stanley argues that, although supposedly objective standard, there is a different standard of materiality for different types of Plaintiffs -- sophisticated plaintiffs, unsophisticated plaintiffs, plaintiffs in the real estate business and others.

For this proposition, Morgan Stanley cites only the report of its own expert Dr. Richards (sic). But, in fact, the standard of materiality is not only objective, it's also unitary. There is a single standard of materiality for all Plaintiffs, and it's not hard to imagine how chaotic it would be for Defendants to understand the scope of their duties, as

1 well as for the courts to administer securities
2 litigation if the standard materiality varied by
3 Plaintiff .

4 So whatever characteristics of Franklin
5 Morgan Stanley thinks are material to the standard
6 materiality can't be because the standard is both
7 objective and unitary .

8 The second fallacy in Morgan Stanley 's
9 view of materiality is that it's somehow necessary to
10 know everything about a total mix of information in
11 order to decide whether an untrue or misleading
12 statement changed the mix of information . Again, from
13 a practical standpoint, if it were the case that
14 courts had to ascertain the total mix of information,
15 securities trials would never end. And there -- on
16 the contrary, there should be some showing about why
17 the untrue or misleading statements would have changed
18 the mix of information in light of the particular
19 information that Morgan Stanley is offering . To say
20 that all the information that was known to Franklin or
21 was available immediately about the mortgage market is
22 not necessary to define whether statements about
23 credit metrics of these loans changed that mix of
24 information.

25 And the third problem with Morgan

1 Stanley's view of the materiality -- and I'll come
2 back to this again in the knowledge defense, Your
3 Honor -- is that it imports a surreptitious reliance
4 defense into the statute, which the legislature has
5 explicitly excluded.

6 Exception for the defenses of knowledge
7 on the statute of limitations, both of which I'll come
8 to you, nothing about the identity of the individual
9 Plaintiff have anything to do with the claim under
10 either the Texas Securities Act or Sections 11 and 12
11 of the 1933 Act.

12 By introducing this information about
13 Franklin in particular, or sophisticated investors in
14 general, there is a great risk that Morgan Stanley
15 will mislead the jury into thinking that the
16 sophistication of the buyer has anything to do with
17 the merits of the Plaintiff's claim. Or even worse,
18 into thinking that because of the sophistication of
19 the buyer, it somehow had a duty to investigate the
20 securities beyond reading Morgan Stanley's disclosure
21 about them. And that is specifically not a law under
22 both the Texas and Federal statutes.

23 THE COURT: Okay. Continue.

24 MR. GRAIS: Secondly, Your Honor, there
25 is a common error in Morgan Stanley's position which

1 rests upon its misinterpretation of the Merck case.

2 THE COURT: Of the?

3 MR. GRAIS: Merck, M-e-r-c-k, in the
4 Supreme Court. We argued the Merck case before, Your
5 Honor, in the initial motions for summary judgment .
6 And it's clear that under the discovery of the
7 elements of the claim standard of Merck, that mere
8 publication of a newspaper article or the filing of a
9 complaint is irrelevant . Because unless it's admitted
10 for the truth of the matter stated therein, which of
11 course it can't be, the mere fact of publication has
12 nothing to do with when the Plaintiff was able to
13 discover all of the elements of its claim.

14 Morgan Stanley seems tacitly to admit
15 that because it says that somehow or another Merck
16 preserved the role for inquiry notice, the former
17 standard that it relies on. And in particular in Page
18 7 of its brief in opposition to our motions, makes the
19 statement that the trier of fact must identify the
20 time at which there was storm warnings, as well as the
21 time at which the Plaintiff actually discovered the
22 elements of its claim.

23 But Merck says nothing like that , Your
24 Honor. What Merck says is that under certain
25 circumstances it may be useful to determine when

1 inquiry notice took place but only under limited
2 circumstances . And apparently, what the Supreme Court
3 had in mind was when a nondiligent Plaintiff argues
4 that it couldn't have begun to investigate sooner.

5 Publications and other material not
6 accepted -- not offered for the truth of the matter
7 stated therein may be relevant to when it could have
8 begun such an investigation . But there is no
9 remaining role for storm warnings or inquiry notice
10 after Merck .

11 And the idea that all of the newspaper
12 articles and complaints against third parties are
13 somehow irrelevant irrespective of the truth of the
14 matter stated therein can't survive Merck as properly
15 interpreted . There simply is no continuing role for
16 inquiry notice .

17 And lastly, Your Honor, the third
18 pervading error, if you will, is Morgan Stanley 's
19 misconstruction of the knowledge defense . The Texas
20 statute specifically provides that the defense is that
21 the buyer was aware of such untruth or omission . That
22 is, unaware -- or aware of the falsity of the specific
23 untrue or misleading statements. That view was, of
24 course, adopted also by Judge Cote in the FHFA case.

25 The purpose of this defense is what

1 might be called no harm, no foul. If the buyer
2 already knew that the statement was false, then the
3 law has no interest in protecting the buyer because it
4 was already aware of the falsity of the statements.

5 But what Morgan Stanley tries to do by
6 offering, particularly, knowledge of Franklin as its
7 sophisticated investor, is began surreptitiously to
8 introduce a due diligence defense or a requirement of
9 due diligence or a requirement to show reasonable
10 reliance.

11 The knowledge requirement, Your Honor,
12 was never intended to do that. It was intended only
13 to negate the untrue or misleading statements.
14 Specifically not to argue that the Plaintiff or the
15 buyer should have known or could have known or had
16 investigated further would have known, because then
17 the knowledge defense as Morgan Stanley construes it
18 slips immediately into requirements on the Plaintiff
19 that the legislature specifically didn't provide.

20 Thank you, Your Honor.

21 THE COURT: I'm sorry. Can you
22 elaborate on the part about it was not -- you said it
23 was not intended -- one moment.

24 (Pause)

25 THE COURT: You lost me on the part that

1 it was intended to negate the untrue or misleading
2 statements . It wasn't intended to do the other . I'm
3 missing the nuance there . Can you restate that?

4 MR. GRAIS: Of course , Your Honor . The
5 knowledge defense is limited to knowledge of a
6 specific -- the untruth or misleading nature of the
7 specific statements that the --

8 THE COURT: Okay. In other words, the
9 actionable statements themselves as opposed to greater
10 knowledge of the market and the -- things like that?

11 MR. GRAIS: Exactly , Your Honor.

12 THE COURT: Okay. All right. So that
13 is the two motions in limine , the knowledge and the
14 newspaper articles , et cetera.

15 MR. GRAIS: Just a brief word about
16 Dr. James in hindsight. Dr. James was designated as a
17 witness on negative causation for which his hindsight
18 studies may be pertinent . But the law is clear that
19 materiality is determined at the time of the
20 investment . In this case , well before Dr. James's
21 study and that nothing that happens after the
22 investment is made is pertinent to whether or not the
23 untrue or misleading statements were material when
24 they were made .

25 What Morgan Stanley says is that in

1 stock-drop cases it's sometimes done to analyze what
2 the market did when the true information was disclosed
3 and therefore the untrue or misleading statement
4 corrected. But as we express in our brief, Your
5 Honor, that is not this case.

6 First of all, the truth has not been
7 disclosed. Secondly, there is not the same liquid and
8 efficient market that there is in stocks. As the
9 Court is aware, the stock exchanges trade tens of
10 millions of shares in most stocks daily.

11 Mortgage-backed securities are traded
12 over-the-counter; episodically prices are not
13 systematically reported. And so the sort of event
14 study that may be customary in stock-drop cases in
15 efficient markets just has nothing at all to do with
16 the determination of materiality in this completely
17 different kind of security.

18 Materiality as Morgan Stanley and other
19 Defendants argue in many other contexts is not
20 determined by hindsight. It has to be determined as
21 of the time when the investor had to evaluate the
22 statement.

23 THE COURT: How would it work in a
24 stock-drop case, what would be an example or
25 circumstance where the subsequent -- when the

1 information -- the true information was disclosed and
2 then the true or misleading statement corrected, what
3 kind of circumstance would that be?

4 MR. GRAIS: If the misleading statement
5 were corrected two weeks later and the stock went
6 down, the materiality of the statement is evidenced by
7 the fact that when the truth became known, the price
8 of the stock reacted.

9 On the other hand, when the truth became
10 known, investors didn't think it was important enough
11 to bid the price of the stock down, then the inference
12 is that it wasn't material. But again, that makes
13 sense only in a highly liquid, highly efficient
14 market. And it makes sense only when the disclosure
15 comes a very short time after the allegedly untrue or
16 misleading statement.

17 Here, years have gone by. And to look
18 back as Dr. James did is something quite different
19 from testing the reaction of the public markets days
20 or weeks between an untrue or misleading statement and
21 a corrected disclosure.

22 THE COURT: But he is looking in
23 hindsight? Or is he actually writing a report that
24 talks about what the -- putting himself back in time
25 and looking forward?

1 MR. GRAIS: No, not at all, Your Honor.
2 He's taking the performance of loans and tracing them
3 through the years after these securitizations closed
4 to see how they performed, which is obviously nothing
5 that could be envisioned at the time of the purchase
6 and sale of the securities. It's strictly by
7 hindsight, Your Honor.

8 It's as if the Plaintiff were to say
9 these loans went into default some months or years
10 after the closing of the securitization and then
11 asking the jury to infer from that that the statements
12 about them were untrue or misleading. The purpose of
13 the statute is to provide sort of a snapshot in time,
14 if you will, Your Honor. Materiality is determined as
15 of the time that snapshot is taken. And subsequent
16 events, with the exception of the corrected disclosure
17 in the efficient market, really have no bearing on
18 what an investor knew at the time it had to make its
19 investment decision.

20 THE COURT: Okay. Response.

21 MS. SESHENS: Is this on?

22 THE COURT: No.

23 MS. SESHENS: Your Honor, do you have a
24 preference as to which I address first?

25 THE COURT: Perhaps go in the same

1 order.

2 MS. SESHENS: Sure. So turning back to
3 the FDIC's motions concerning evidence of knowledge
4 and the articles and the complaints, I'll address that
5 first. And then turn to the motion concerning
6 Dr. James and his materiality opinion.

7 I think contrary to the FDIC's position,
8 Morgan Stanley is not taking an overly broad view of
9 materiality. In fact, we recognize and it is in our
10 papers and I think the parties agree that the standard
11 for materiality is an objective one.

12 A material or omitted fact -- a
13 misstatement or omitted fact, rather, is material if
14 there is a substantial likelihood that the disclosure
15 of the misstated or omitted information would have
16 been viewed by the reasonable investor as having
17 significantly altered the total mix of information
18 made available. That is the standard, and I believe
19 the parties all agree.

20 What comprises that total mix of
21 information is in part where the parties disagree.
22 And we've cited several cases in our brief, including
23 the Kapps case, a Fifth Circuit Section 11 decision
24 that the FDIC does not address in its reply, where the
25 Court looked to publicly available information as part

1 of the total mix to render a disclosure immaterial as
2 a matter of law. And it is that kind of publicly
3 available information that Morgan Stanley contends is
4 relevant to the materiality determination.

5 Similarly we've cited cases that talk
6 about information known to the Plaintiff as being
7 relevant to the total mix. The standard for
8 materiality does seek to look at materiality from the
9 perspective of the reasonable hypothetical investor,
10 but that reasonable hypothetical investor has to be
11 similar to or standing in the Plaintiff's shoes.

12 So, for example, you can't have a
13 reasonable investor in an RMBS case who is completely
14 unfamiliar with the mortgage markets or who doesn't
15 understand RMBS. That was not the market for
16 residential mortgage-backed securities. These were
17 not, generally speaking, retail investors. There's a
18 profile that comprises the reasonable hypothetical
19 RMBS investor, and it is Morgan Stanley's contention
20 that that investor is just like Franklin Bank.

21 And, in fact, Morgan Stanley's
22 materiality expert Mr. Richard has offered his
23 opinions, as has the FDIC's materiality expert, about
24 what was important to residential mortgage-backed
25 securities investors. And they talk about different

1 characteristics of the securities, different
2 information that is available to them.

3 And Mr. Richard opines that Franklin
4 Bank is just like the reasonable hypothetical
5 mortgage-backed securities investor. The FDIC has not
6 sought to exclude that opinion. And evidence about
7 what Franklin Bank knew and the total mix of
8 information is relevant to that.

9 Similarly, the FDIC doesn't cite any
10 decisions to the contrary. They noted in their brief
11 and Mr. Grais mentioned the FHFA case. The
12 materiality decisions there were actually quite
13 different. And there, there were opinions and
14 information about materiality that went to the
15 idiosyncratic nature of the Plaintiff in that case.
16 The Plaintiffs, I should say, which were Fannie Mae
17 and Freddie Mac, referred to as the GSEs generally;
18 and they had an idiosyncratic whole loan business.

19 Whereas here, the opinions and the
20 evidence show that Franklin Bank had a very typical
21 whole loan business. And, in fact, Franklin Bank
22 originated, sold and purchased the exact same type of
23 loan that backs these securities that are at issue.

24 And so we contend, Your Honor, that
25 under the standard of materiality as the parties agree

1 to it, information that is publicly available that is
2 part of the total mix that is known to Franklin Bank
3 compromises the total mix of information that's
4 relevant to the materiality determination as seen from
5 the perspective of a reasonable RMBS investor standing
6 in the shoes of Franklin Bank . It is also --

7 THE COURT: So you're arguing their
8 knowledge -- so you're going -- so help me state this
9 correctly. Where FDIC is saying that the materiality
10 is only related to the representations related to the
11 actionable investment decision , you're saying that
12 materiality goes beyond that to the, which is what
13 they're concerned about in a roundabout way, talking
14 about the more broadly Franklin Bank 's knowledge of
15 the industry or the market itself.

16 MS. SESHENS: We do think that's
17 relevant, Your Honor, to demonstrate what a reasonable
18 investor in Franklin Bank 's shoes would have known and
19 understood. We do agree with the FDIC that
20 materiality is an objective standard and that it is
21 assessed from the position of a reasonable RMBS
22 investor .

23 We do think that information in the
24 public domain compromises the total mix of information
25 available to reasonable RMBS investors, and that

1 certain characteristics of Franklin Bank are
2 reflective of and similar to the characteristics of a
3 reasonable RMBS investor in part as opined upon by our
4 materiality expert.

5 THE COURT: That's nice, but what you're
6 really trying to do is use that opening to drive a
7 truck through to show all the things that they're
8 concerned about you showing.

9 MS. SESHENS: Well, respectfully, Your
10 Honor, we're not intending to do that. I take a bit
11 of umbrage with the notion that there's going to be
12 some reliance defense here when there will be a jury
13 charge that has nothing to do with reliance and
14 there's not going to be discussion of reliance and
15 it's not an element of a claim and it's not an element
16 of a defense. So it's --

17 THE COURT: Please slow down.

18 MS. SESHENS: I apologize, Your Honor.

19 THE COURT: It's okay.

20 MS. SESHENS: So it's unclear to us how
21 the jury is somehow going to think that reliance is at
22 issue here. We do think that the evidence that is at
23 issue in these two motions is relevant to various
24 components of the case, but materiality is clearly one
25 of them. We do think it is appropriate under the law

1 to consider that information; but there are other
2 avenues, obviously, that we think it's relevant to as
3 well.

4 THE COURT: Like what?

5 MS. SESHENS: So as we've put forth,
6 Your Honor, evidence of what Franklin Bank knew and
7 evidence of what Franklin Bank should have known based
8 on, for example, the articles and the complaints that
9 the FDIC challenges are relevant both to Morgan
10 Stanley's knowledge defense, as well as to Morgan
11 Stanley's burden to rebut the FDIC's showing of lack
12 of knowledge under Section 12.

13 THE COURT: I'm sorry. That was a
14 triple negative. Can you say that --

15 MS. SESHENS: Yes, of course. So under
16 Section 11, Morgan Stanley has a knowledge defense
17 where if it can show that Franklin Bank knew of the
18 alleged misstatements and omissions, there can be no
19 liability.

20 THE COURT: Right.

21 MS. SESHENS: Under Section 12, it is
22 the Plaintiff's burden to show that the Plaintiff did
23 not know of the alleged misstatements and omissions.
24 And it is then Morgan Stanley's opportunity to rebut
25 that showing if the Plaintiff is able to make it.

1 That's just a difference in the burdens under the two
2 Federal statutes .

3 So we think that the knowledge evidence
4 and the -- well, the knowledge evidence is obviously
5 directly relevant, we contend, to the knowledge
6 defense . The knowledge evidence, as well as the
7 newspaper articles and complaints --

8 THE COURT: What is the nature of that
9 knowledge -- what is the knowledge -- is it a
10 knowledge of the falsity of those specific
11 representations, no, or omissions?

12 MS. SESHENS: That is what the FDIC
13 contends. We do not think that it's drawn that
14 tightly. We do think that the general knowledge is
15 relevant, that the knowledge of the misstatements and
16 omissions can be shown through the evidence that we've
17 put forward. It is more circumstantial, but we don't
18 think it's drawn as tightly as the FDIC .

19 And we also, Your Honor, believe that
20 that evidence is relevant to our statute of
21 limitations defense . I can pause for a moment if Your
22 Honor has further questions on knowledge .

23 THE COURT: Yeah, please pause for just
24 a moment .

25 MS. SESHENS: Sure .

1 (Pause)

2 THE COURT: So can you give me -- I'll
3 ask you first, Ms. Seshens, and then Mr. Grais. As a
4 practical matter, what would your two -- I'm trying to
5 grasp the practical differences between the two
6 standards of knowledge that you're talking about as it
7 relates to this motion in limine where you're
8 saying -- where the Plaintiff is saying that the only
9 knowledge that's important -- that's material is their
10 knowledge about the specific representations that are
11 actionable here, as opposed to where you're saying
12 that it's more broad than that and a total mix of
13 information that touches on at least in part the
14 market.

15 I know I'm not phrasing that accurately
16 or precisely. But when we talk about Franklin Bank's
17 knowledge about the representations, it's easy to --
18 that's easy to say. But as a practical matter, what
19 does that really look like on the ground in real time?

20 In other words, if you're telling me the
21 sky is blue -- which there's laws about that. If
22 you're telling me that the sky is blue and I have
23 access to -- I'm not going to be able to do this
24 properly.

25 I can't imagine that it is so

1 laser-focused to be able to say that the evidence that
2 relates to their knowledge about these representation s
3 is in this tiny little cylinder and you can look down
4 in it and it's straight as an arrow. There's going to
5 be real-world knowledge that the actual human beings
6 at Franklin Bank had at the time that these
7 representation s were made.

8 Or are you saying, Mr. Grais, that the
9 only material knowledge is their knowledge of the
10 characteristics of these specific investment vehicles
11 that were being offered to them at that time? Or is
12 it more broad than that? And if it is, how is that
13 practically different than what Morgan Stanley 's
14 arguing?

15 MR. GRAIS: It's the former, Your Honor.
16 It's specifically it's knowledge of the fact that
17 Morgan Stanley misstated the characteristics of these
18 investment vehicles, these particular investment
19 vehicles. And the Texas statute makes that clear by
20 saying that the knowledge defense applies if the buyer
21 knew that such untrue or misleading statements, if you
22 already knew this, such statements were untrue or
23 misleading. So the focus of the statute is on the
24 untruth of the specific statements that the Defendant
25 made while selling the securities.

1 A related point, Your Honor, is that
2 there is no concept of should have known in the
3 knowledge defense. In the statute of limitations
4 defense there is, of course, the standard of when the
5 Plaintiff discovered or should in the exercise of
6 diligence have discovered, there is no such concept in
7 the knowledge defense. It is purely a question of
8 actual knowledge.

9 To import a should-have-known
10 requirement is then to import a requirement of due
11 diligence investigation on the part of the investor,
12 which both the legislature and Congress expressly
13 omitted.

14 THE COURT: And you're saying that's
15 under Texas law but in a Federal claims that are in
16 this case? (Sic)

17 MR. GRAIS: The same is true, Your
18 Honor. The knowledge requirement focuses on the
19 untrue or misleading statements specifically. In
20 neither case is there a component of should have
21 known.

22 THE COURT: Okay. So let me ask my
23 question one more time, then. I appreciate what
24 you've said and that gives me better understanding of
25 your view of the requirement. But what is -- again,

1 what does that look like, how does someone in the
2 position of authority at Franklin Bank to make these
3 decisions know about the truth or falsity of these
4 representations?

5 MR. GRAIS: Well, our view is that it
6 wasn't possible because Morgan Stanley didn't disclose
7 information from which it could be told. And they
8 didn't know. I suppose had Morgan Stanley taken a
9 different course and made the loan files available for
10 inspection, for example, and had a hypothetical
11 investor inspected the loan files, that perhaps could
12 have conveyed knowledge that Morgan Stanley made
13 untrue and misleading statements about the loans. But
14 that's not what happened here.

15 THE COURT: All right. Could you try to
16 go back and respond to the question that I asked a
17 moment ago?

18 MS. SESHENS: Yes, absolutely, Your
19 Honor. If I don't address it, please let me know. I
20 think what Your Honor is driving at is how will this
21 play out at the trial, what kind of evidence are we
22 talking about. I think -- I don't want to speak for
23 the FDIC, but I understand their position.

24 It would have to be evidence that
25 Franklin Bank knew that the specific loans in the

1 specific supporting loan groups were not as they were
2 reported to be. I think our position has been
3 Franklin Bank had knowledge about originators of these
4 loans, knew about, for example, rampant
5 owner-occupancy fraud and amongst themselves remarked
6 that they couldn't believe that everybody out in the
7 world was now learning what Franklin Bank had known
8 for a while, which is that owner-occupancy fraud was
9 prevalent and there are owner-occupancy allegations in
10 this case.

11 And so we would contend that knowledge
12 of widespread owner-occupancy fraud is knowledge
13 related to the alleged misrepresentation s here. So
14 that's one particular example.

15 There are similar examples with
16 appraisal fraud, as well. There is evidence of
17 knowledge of appraisal fraud in the industry. And so
18 that, from our perspective, is probative of Franklin
19 Bank's knowledge of the alleged misstatements here
20 concerning inflated appraisals. Those are just two
21 examples. I'm happy to provide some others.

22 THE COURT: So would you address those
23 examples, then. So what counsel is saying -- and I'm
24 not telling you anything you don't know, but what
25 counsel is saying is that there is some amount of

1 experience and knowledge of the universe of these RMBS
2 securities -- or that's redundant -- RMB securities
3 that an investor would probably -- let's say they had
4 actual knowledge .

5 Let's just say for argument sake they
6 had actual knowledge of these concerns in the
7 industry . Would that be relevant to this knowledge
8 defense, or not at all? It's only the narrow rightful
9 shot of what was told and what was not told?

10 MR. GRAIS: Exactly, Your Honor. It's
11 as though someone were told, as Ms. Seshens posits,
12 there's a lot of occupancy fraud going on out there.
13 And from that, Ms. Seshens would ask the Court and
14 jury to infer that the Plaintiff knew that Morgan
15 Stanley had made misstatements about the specific
16 loans in its transaction on which vehicle one of its
17 fellow underwriters was doing due diligence .

18 It's important to remember, Your Honor,
19 of course, that underwriters vet these loans and make
20 filings with the SEC about them. What does not
21 suffice is that a diligent investor would have found
22 reason to investigate or anything like that . The only
23 relevant point is whether or not the investor knew
24 that those specific statements were untrue.

25 THE COURT: And that's the Merck case?

1 Or is that a different -- what's the best case for
2 that?

3 MR. GRAIS: Well, the best case, Your
4 Honor, is -- one is Judge Cote's opinion in the FHFA
5 case, which is cited in our brief. And the other is
6 just the plain language of the Texas statute, which
7 limits the knowledge defense to knowledge or the
8 falsity of such untrue or misleading statement, the
9 specific one.

10 THE COURT: All right. I'll give you
11 the last word, real briefly.

12 MS. SESHENS: Sure, Your Honor, if I
13 may. Two quick points. I think one is Mr. Grais has
14 been injecting this should-have-known standard as
15 we've been talking about the knowledge defense. That
16 relates to the statute of limitations defense.

17 THE COURT: I wasn't confused about
18 that.

19 MS. SESHENS: Okay. So we're talking
20 knowledge, we agree and understand we're talking about
21 actual knowledge. The statute of limitations defense
22 is different. I just want to touch upon that briefly.

23 The FDIC has repeatedly contended that
24 inquiry notice, storm warnings, information about
25 Franklin Bank, quote, unquote, should have known is

1 entirely irrelevant under Merck. And we have trouble
2 understanding how that position is tenable given that
3 Merck itself, for example, looked at pleadings in the
4 public domain to determine the timeliness of the
5 claims. That's in the Supreme Court case itself.
6 Pension Trust, a Third Circuit decision we cite in our
7 papers, in fact, applied Merck but applied inquiry
8 notice within its analysis.

9 And, in fact, Judge Cote, who Mr. Grais
10 just cited for the Nomura -- the FHFA/Nomura decision ,
11 also relied upon the inquiry notice standard in her
12 Merck analysis. And so to contend that inquiry notice
13 or what Franklin Bank should have known is irrelevant,
14 even if Merck were to apply. And it is obviously our
15 position that it does not. It finds no support, from
16 our perspective, in the law; and we think that it is
17 just wrong.

18 As a result, the motion that is directed
19 to the complaints and the newspaper articles we think
20 should be denied both because those are relevant, as
21 we've discussed, but because they also are not hearsay
22 because they're not being offered for the truth of the
23 matter asserted therein.

24 THE COURT: They're not being offered
25 for the truth of the matter asserted therein; they

1 were being offered to show when they should have been
2 on inquiry notice?

3 MS. SESHENS: To show the fact that they
4 were -- exactly, their existence in the market and to
5 show when they should have been on inquiry notice.

6 THE COURT: Of course the fact -- what
7 would have tipped them off would be the truth of the
8 matter asserted, no?

9 MS. SESHENS: Well, not necessarily.
10 You could have an article that relayed lots of
11 information that caused you to question your
12 investment, but it's not necessarily the case that the
13 information had to be accurate. It could have just
14 caused you to question it.

15 Our position is that the information
16 that is in the public domain is sufficient to put an
17 investor, Franklin Bank in this case, on notice. And
18 the cases are legion that say that you can rely on
19 complaints and articles in order to do that.

20 THE COURT: It sounds like what you've
21 been talking about in this last little bit, maybe I
22 missed it, is just the statute of limitations issue.

23 MS. SESHENS: That's correct. The
24 articles and complaints we think relate both to
25 materiality as part of the total mix of information as

1 we talked about and also the statute of limitations
2 defense .

3 And I'm also happy to address Dr. James,
4 Your Honor, whenever you would like me to do so.

5 COURT'S RULING

6 THE COURT: Before we get to the expert,
7 I'm going to rule that -- I'm going to grant the
8 motion in limine as to materiality and deny it as to
9 statute of limitations . And so we may need to create
10 some sort of instruction for the jury as to the
11 purpose for which they may consider that information .

12 MR. GRAIS: Thank you , Your Honor.

13 THE COURT: All right. And the expert,
14 Ms. Seshens?

15 MS. SESHENS: Certainly , Your Honor.
16 The FDIC, as they've stated, challenges Dr. James's
17 opinion as being an improper hindsight analysis of
18 what was important to an investor , a hypothetical
19 reasonable investor at the time of investment . We
20 don't dispute that materiality is assessed as of the
21 time of investment . But just because that is the
22 case, it does not proscribe any number of different
23 analyses to demonstrate that.

24 In many ways the materiality experts
25 here are all looking backward in time, but there's no

1 one way to show materiality . We've shown through the
2 cases we've cited that it is commonplace in the
3 securities cases to look at information after the fact
4 to assess materiality . The standard that applies in
5 those cases is no different than what applies here .
6 It's the same materiality standard. And the rationale
7 for why courts in, for example , Section 10(b) cases
8 look at materiality by focusing on stock price
9 movement is because the theory is information that is
10 important to investors moves stock prices.

11 Dr. James has applied the same theory
12 here in an empirical way, which is information that is
13 important to reasonable RMBS investors in past
14 performance . He's just showing it -- he's an
15 economist -- from an empirical perspective .

16 Mr. Richard and Ms. Rutledge, the two
17 materiality experts in this case, are offering their
18 materiality opinions based upon their experience in
19 the market .

20 Dr. James is simply showing from an
21 empirical perspective how these factors would have
22 been or would not have been important to a reasonable
23 hypothetical investor .

24 Ms. Rutledge , for example , could have
25 conducted the same study. And had her study shown

1 that these characteristics that are allegedly
2 misstated impacted loan performance, the FDIC could
3 have relied on that analysis to show materiality. I
4 imagine if that study would have borne that out, we
5 wouldn't have had this motion here today.

6 Now, the cases actually support various
7 ways to prove materiality. Event studies are only one
8 of them. For example, a company can restate its
9 financial information. And that can render -- and
10 restatements generally arise out of material errors in
11 the financial statements, let's say. But you can't
12 determine if a prior misstatement was material based
13 upon a restatement unless and until you have the
14 restatement. And so you have to consider what has
15 happened after the fact.

16 The Burlington case that the FDIC cites
17 very prominently in its briefing talks about an event
18 study, and it relies upon that to analyze a stock
19 price drop. But then there's a section of the opinion
20 that looks at an alleged omission -- allegedly omitted
21 disclosure about discounts for supplies of coats.
22 It's Burlington Coat Factory, I believe was the
23 Plaintiff. And that the supplier wasn't giving as
24 large a discount to Burlington for two particular
25 months; and therefore, Burlington's costs were higher

1 and its numbers were not accurately reported.

2 The Court deemed that immaterial by
3 looking at the full-year cost of goods and saying
4 within that context those two months are not material
5 because the cost of goods didn't rise overall. So the
6 Court necessarily considered additional information
7 after the alleged misstatement to determine the
8 materiality. It is just another way of looking at it.
9 Particularly when the analysis is from the perspective
10 of a reasonable hypothetical investor. What would
11 have been important to the investor. You can show it
12 the way Ms. Rutledge tries to do it by talking about
13 her experience.

14 But you also can show it empirically by
15 looking at other factors and doing an economic
16 analysis and that's what Dr. James has done. We think
17 there's tons of support for it in the case law. The
18 FDIC has not challenged the underlying analyses; and
19 we therefore think it's appropriate in this case.

20 THE COURT: And so what does it mean --
21 what does that mean in terms of how the study was
22 performed, to look at something from hindsight versus,
23 as you say empirically -- in other words, can you --
24 what's the word I'm looking for? Help me understand
25 the relationship between those two concepts, the idea

1 of hindsight and then empirically. What are you
2 really saying?

3 MS. SESHENS: Sure. So what Dr. James
4 did was he took a look at the performance of the loans
5 that are in one group versus the performance of the
6 loans in other groups to see how allegedly defective
7 loans performed versus allegedly nondefective loans.
8 I'm sort of simplifying for present purposes, but
9 that's the gist of what he did. And the FDIC's
10 contention is that that's impermissible because loan
11 performance information wasn't available to an
12 investor at the time of investment.

13 THE COURT: Okay. That's right, the
14 word is "harmonized" is what I was trying to look for.
15 So therefore?

16 MS. SESHENS: So they're contending that
17 you can't do that, and we're saying it's entirely
18 appropriate. People do it all the time in securities
19 cases, as reflected in the stock-drop cases, as
20 reflected in the Burlington case, as reflected in
21 cases that look at restatements as evidence of
22 materiality. That because it's a reasonable
23 hypothetical investor, what would have been important.

24 You can demonstrate that multiple ways.
25 You can show it by, as the FDIC is trying to through

1 Ms. Rutledge, who has opinions about what was
2 important in the investment process; but you can show
3 empirically on the same theory that applies to the
4 stock-drop cases where the same standard of
5 materiality applies as it does across Section 10(b)
6 and across Section 11 and across Section 12 .

7 So our position is that it is just one
8 way of showing materiality and there's nothing in the
9 materiality standard or in any of the case law that
10 precludes an expert from doing so.

11 THE COURT: But do you agree that what
12 Ms. Rutledge is doing is looking at it at the time ,
13 whereas the empirical analysis is in fact using
14 hindsight?

15 MS. SESHENS: No, no, I don't, Your
16 Honor. And this is why. I think Ms. Rutledge is
17 necessarily looking back at the time from after the
18 fact with all of the information she knows now and all
19 of the experience she's had since then.

20 She does render her opinions, as does
21 Mr. Richard , our materiality rebuttal expert, about
22 what was important to reasonable RMBS investors. But
23 I don't think that Dr. James is looking at it with
24 hindsight to be sure he's using information that is
25 available -- that was available after the time of

1 investment --

2 THE COURT: Only after the time of
3 investment.

4 MS. SESHENS: That is correct . But he
5 is doing that to demonstrate what would have been
6 important to a reasonable investor at that time
7 because what would have been important to a reasonable
8 investor at that time was information that impacted
9 loan performance . It's the same theory that underlies
10 looking at stock price movements to demonstrate the
11 materiality of previously disclosed information .

12 THE COURT: Response.

13 MR. GRAIS: May I briefly, Your Honor?

14 THE COURT: Yeah.

15 MR. GRAIS: The gist of what Dr. James
16 did is to use the fact that the country had the
17 greatest recession since the Great Depression. To
18 obliterate the materiality of the misstatements that
19 Morgan Stanley just made, may I just give Your Honor
20 an example?

21 Many investors would say that if the
22 LTVs of the mortgage loans had an average of 75
23 percent, that would be sufficient to avoid default on
24 their bond in all circumstances of recession that the
25 United States had seen in the last 50 years .

1 If it had been 85 percent, they would
2 say that would not give us enough protection. So the
3 difference between 75 and 85 percent when looked at
4 without foreknowledge of the future is very important
5 because in the context of the recessions that the
6 United States have experienced up till then, that made
7 a big difference in the safety of the bond. Well,
8 what happened is that along came the greatest
9 recession and it overwhelmed both of those
10 protections. And so even an LTV of 75, while
11 sufficient to protect the bond under normal
12 circumstances, proved to be insufficient to protect it
13 in these extreme circumstances.

14 All Dr. James is doing is saying it
15 turned out that this was the greatest housing debacle
16 ever and loans all performed badly because the
17 differences in quality ceased to be important in the
18 face of the economic disaster, but nobody knew that
19 that was coming.

20 And looking forward, investors analyzed
21 these loans and said, Given the circumstances that I
22 predict, the difference between 75 and 85 is very
23 important. The fact that even 75 couldn't withstand
24 the great recession is pure hindsight and irrelevant
25 besides because really what Dr. James should have done

1 is figured out how those loans would have performed
2 under a variety of economic scenarios if he wanted to
3 do a real post-facto analysis.

4 That's why whatever Ms. Seshens may say
5 about event studies in stock-drop cases, this
6 post-facto view that because the recession loans
7 performed poorly irrespective of where their LTVs were
8 is just a comment on the severity, the housing prices,
9 it's not a comment on materiality of that information
10 at the time the investor was looking forward.

11 MS. SESHENS: If I may, Your Honor?
12 Which is just one last point. I think what Mr. Grais
13 has just articulated is the FDIC's perhaps
14 cross-examination or response to Dr. James but not a
15 reason to render his opinion inadmissible.

16 THE COURT: How does looking at the
17 stock -- or how is his analysis relevant to a question
18 that the jury will be answering?

19 MS. SESHENS: The jury will be asked,
20 Your Honor, to assess the materiality of the alleged
21 misstatements and omissions, and his analysis would be
22 relevant to that determination.

23 THE COURT: Well, okay. I understood
24 that part. But I mean if we're looking at -- if I've
25 already assessed the materiality from the -- if it

1 can't be a backwards-looking view -- I'm still
2 struggling with the relevance.

3 MS. SESHENS: So some of this gets into
4 more of the granularity of mister -- I keep calling
5 him mister; he would be offended by that --
6 Dr. James's study, which in fact controlled for
7 identified groups of loans based on the alleged
8 defects that the FDIC's experts identified in the
9 loans about departures from underwriting guidelines,
10 inflated appraisals and the like. And so those are
11 the very alleged misstatements at issue in this case .

12 So Dr. James separated the loans based
13 upon those characteristics and then controlled for
14 other characteristics that could otherwise impact
15 performance. And so he tested the very materiality of
16 the specific alleged misstatements at the very loan
17 level in this case according to the FDIC's expert .

18 So it's directly relevant, these loans,
19 these offering documents; and it's exactly in that
20 spot. So it would be an analysis that the jury could
21 look to as it considers materiality as a complement to
22 Mr. Richard, our materiality expert, and as somebody
23 who is either contrary to or rebuttal to Ms. Rutledge,
24 who will be offering the FDIC's opinions, as we
25 understand it.

1 THE COURT: And if you can, articulate
2 the different conclusions between Ms. Rutledge and
3 Dr. James?

4 MS. SESHENS: I think Ms. Rutledge, and
5 obviously Mr. Grais can correct me if he thinks I've
6 gotten this wrong, in a nutshell will testify to the
7 various characteristics of residential mortgage-backed
8 securities that she thinks were important to investors
9 as part of their investment decisions and she'll focus
10 on, perhaps not surprisingly, the alleged -- the
11 characteristics that are at issue in this case. She
12 will focus on some others but, you know, LTV ratios,
13 owner-occupancy, conformity with underwriting
14 guidelines; and she'll opine that those were
15 important.

16 We obviously -- we actually don't think
17 that goes far enough, but that's an issue for a
18 different day. Whereas Dr. James --

19 And she'll provide no empirical
20 evidence, she has performed no studies, she's
21 undertaken no analysis. It is just her views based on
22 her experience.

23 Dr. James, however, has undertaken an
24 analysis. Because he's an economist, it is his view
25 generally -- again, I hope I'm attributing to him

1 okay -- but that you can test these propositions, you
2 can test empirically whether LTV ratios or the
3 allegedly misstated LTV ratios were important to a
4 hypothetical reasonable RMBS investor. And that's
5 what he set out to do. He's simply --

6 THE COURT: Doesn't that sound more like
7 causation than materiality?

8 MS. SESHENS: I don't think so , Your
9 Honor. Because the concept is what is material , what
10 is important will impact loan performance . And loan
11 performance is what is most important to an RMBS
12 investor because it impacts the investor's ability to
13 obtain cash flows that it's otherwise owed under the
14 security. So it goes directly to what is most
15 important because it is what impacts the ability for
16 the investor to get paid.

17 THE COURT: But they wouldn't -- but how
18 do they base an investment decision on that if you are
19 -- it would be impossible for them to have that
20 information at the time they made the investment
21 decision.

22 MS. SESHENS: Correct, as it relates to
23 these specific populations of loans , yes.

24 THE COURT: And so is his analysis of
25 these loans, as you say, empirical? Or is his

1 analysis more broadly the RMBS market?

2 MS. SESHENS: His analysis is of these
3 loans, an empirical analysis of these loans.

4 THE COURT: So tell me, then, one more
5 time. If it is impossible for them to have had this
6 information, how is it material in their investment
7 decision?

8 MS. SESHENS: Well, it shows that it's
9 not material. It's a way of demonstrating a lack of
10 materiality. He's not saying --

11 THE COURT: But doesn't that stand the
12 concept of materiality on its head?

13 MS. SESHENS: I don't believe so, Your
14 Honor. Because, again, while you have to look at
15 materiality at the time of investment, you can show
16 materiality through many different ways. You can look
17 at it from all different perspectives.

18 THE COURT: If the stocks -- well, never
19 mind. That's a different statement. Start again.
20 What does it mean to say that you can look at
21 materiality in lots of different ways? Materiality is
22 what you base -- what are the variables that go into
23 making your investment decision?

24 MS. SESHENS: Correct. The question
25 here for materiality, as Morgan Stanley sees it, is

1 whether the alleged misstatements and omissions as
2 identified by the FDIC would have been material to a
3 reasonable investor. It's hypothetical.

4 THE COURT: And separately, as I had
5 said a moment ago, is a causation. Or is there not --
6 I know we talked about negative causation, but I don't
7 remember from the 20 or 30 hearings we've had whether
8 causation is an element. Here it's not.

9 MS. SESHENS: Causation is not an
10 element of the FDIC's affirmative case. It is an
11 affirmative defense for Morgan Stanley.

12 THE COURT: That it didn't cause?

13 MS. SESHENS: Correct, that the alleged
14 misstatements --

15 THE COURT: Would this --

16 MS. SESHENS: -- and omissions did not
17 cause --

18 THE COURT: Carolyn, I'm so sorry.

19 MS. SESHENS: -- the loss.

20 THE COURT: Would Dr. James's analysis
21 also be -- or would it be relevant or is part of what
22 he's going to testify -- is he a negative or one of
23 the negative causation experts?

24 MS. SESHENS: He is, Your Honor. That
25 is correct.

1 THE COURT: Because it really sounds to
2 me like you're talking about -- I don't mean
3 conflating in a negative way like you did something
4 wrong. But it seems like you're attempting to have
5 the Court conflate the concepts of materiality and
6 negative causation.

7 MS. SESHENS: I think from our
8 perspective, Your Honor, we think that the analysis
9 actually can support both. And it's not conflating
10 them because they're two separate concepts and the
11 empirical analysis, the underlying studies that
12 Dr. James conducted, can give rise to different expert
13 conclusions.

14 THE COURT: All right. So one more
15 time, then. Let's flip this around .
16 Ms. Rutherford (sic)?

17 MS. SESHENS: Ms. Rutledge.

18 THE COURT: Ms. Rutledge, excuse me.
19 Rutledge was the Giants' quarterback . Rutherford
20 is where the Giants play.

21 (Laughing)

22 MS. SESHENS: I'm not going to tell
23 you I'm an Eagles fan.

24 THE COURT: Boo. You're the one.

25 MS. SESHENS: I am the one.

1 THE COURT: The -- now I lost my
2 train of thought .

3 Okay. So look at Ms. Rutledge , and
4 her analysis is -- do you agree that her analysis
5 is at the time and not looking backwards ?

6 MS. SESHENS: I would actually take
7 issue with the notion that she has an analysis.

8 THE COURT: All right . Excuse me .
9 Her --

10 MS. SESHENS: I think that her
11 perspective is that she is trying to opine on what
12 would have been important, what was important to
13 RMBS investors when they made investment decisions .

14 THE COURT: Okay. So then it's fair
15 to say , then, for better or worse , she's not
16 looking at the performance over time. So she
17 doesn't fall into that potential trap.

18 Are there other experts of theirs
19 that have any sort of analysis? That is , looking
20 at these loans over time? Do they have -- they
21 have their own negative causation expert , I would
22 imagine , to rebut your --

23 MS. SESHENS: They have a rebuttal
24 causation expert , yes.

25 MR. GRAIS: Your Honor , our two most

1 important experts on our liability case are those
2 who will testify about whether or not the loans
3 complied with underwriting standards and whether or
4 not the appraisals were done properly. In both
5 cases we have specifically removed from the files
6 they reviewed any document dated after the loan was
7 paid precisely to avoid this problem of hindsight.

8 MS. SESHENS: I think -- Your Honor,
9 to be fair, I think it's hard to say that the
10 FDIC's experts don't do a hindsight analysis. They
11 are going back in time and they are rereviewing
12 what was done and reanalyzing it based upon , in
13 some instances we contend , additional information
14 and things that were not known at the time. And
15 it's exactly what they are doing.

16 Now, that's not something that's
17 before Your Honor today , but I think in fairness
18 that is what is going on both with the appraisal
19 and the reunderwriting expert .

20 THE COURT: And the case that stands
21 for the proposition that it should not be a
22 hindsight analysis , your best case is what ?

23 MR. GRAIS: Frankly, I'm not sure
24 which are the ones we cited in the brief I would
25 most recommend, Your Honor, but there are many,

1 many.

2 THE COURT: All right. Let me try
3 the other bite. What should I look at to support
4 your argument that this analysis of looking at the
5 performance over time is something that could be
6 considered, the Burlington case?

7 MS. SESHENS: I think the Burlington
8 case supports that. The Gebhardt case that the
9 FDIC actually has cited--

10 THE COURT: Did you say Geb?

11 MS. SESHENS: G eb. G-e, B as in boy,
12 h-a-r-t (sic). Those are two cases that support,
13 we think, our position.

14 And I apologize, Your Honor, there
15 are a number we cited for the notion that you can
16 look at after-the-fact information to assess
17 materiality in the 10(b) context. I don't have
18 those cites immediately, but I can provide them to
19 you before the end of the hearing, if that would
20 work.

21 THE COURT: Sure.

22 MS. SESHENS: Okay.

23 THE COURT: Okay. I'd like to look
24 at those cases one more time.

25 MS. SESHENS: Sure.

1 THE COURT: Just to see if I can
2 discern a bright -line rule .

3 MR. GRAIS: Your Honor ?

4 THE COURT: I mean, I do think that
5 information would naturally be relevant to negative
6 causation . I'm not certain that it's relevant to
7 materiality.

8 MR. GRAIS: May I just ask one
9 question to clarify the Court's order on the other
10 two motions ?

11 Your Honor said you were denying the
12 motions with respect to the statute of limitations.
13 I assume that that's the one on newspapers and
14 complaints against third parties.

15 THE COURT: Right . The other one
16 doesn't seem to lend itself to that.

17 MR. GRAIS: And then you said you
18 were granting the one as to materiality , which I
19 assume is the knowledge part.

20 THE COURT: Yes.

21 MR. GRAIS: Thank you, Your Honor.

22 THE COURT: Yes. Okay. Now I guess
23 -- so let me hold off on the Dr. James part. And I
24 guess we'll turn to your omnibus motion. It's
25 exactly 4:01. That's pretty good. So there's just

1 a handful that are -- have been agreed to or worked
2 out?

3 MS. SESHENS: That is our
4 understanding, Your Honor. And we've gleaned that
5 from the FDIC's opposition papers, so I can't say
6 with certainty that they won't stand up today and
7 say that that's not the case. But I'm happy to
8 identify the ones that we think -- there are two.
9 I apologize. There are two they have said
10 affirmatively they're not opposing. And then
11 there's three others -- three and a half we've
12 identified as ones they don't contest in their
13 opposition. And so I'm happy to run through.

14 I don't know if Your Honor has our
15 Appendix A to our motion, which is this chart that
16 lists out every motion and sub motion. We can pass
17 up a copy if it would be -- yeah, it's become my
18 Bible on me, so I thought it might be helpful to
19 Your Honor.

20 THE COURT: Dana's Bible?

21 MS. SESHENS: Yes.

22 THE COURT: Where did he go --

23 MS. SESHENS: Or Torah. Depends on.

24 . .

25 THE COURT: Where did Dana Bible go?

1 You got nothing for me .

2 MR. YETTER: No, I'm sorry , I don't.

3 That doesn't --

4 (Laughing)

5 MR. CALLAHAN: Your Honor, that would
6 be the University of Texas . Dana --

7 THE COURT: Dana X. Bible, right ?
8 Yes.

9 MS. SESHENS: Now you've completely
10 lost me .

11 MR. CALLAHAN: Football coach.

12 THE COURT: Sorry . The University of
13 Texas.

14 Okie doke. Well, let's just start at
15 the beginning , then , and somebody jump up from the
16 other side and tell me if you don't oppose it.

17 So Motion In Limine Number 1 ,
18 Full-Principal Method of Calculating Interest and
19 Damages.

20 MS. SESHENS: Yes. So I'm happy to
21 start there, Your Honor. This motion is directed
22 at the FDIC's damages expert Ms. Rutledge and her
23 opinion on what she terms the full -principal
24 method.

25 Before I get into the substance , I

1 just wanted to identify a few key points.
2 Obviously this motion assumes that Ms. Rutledge
3 testifies at trial and she's not excluded for the
4 reasons that were raised in our prior Daubert
5 motion.

6 I did want to frame the issue for the
7 Court by noting that based on Ms. Rutledge's
8 opinions, we think that is at least a
9 25-million-dollar issue. And, in fact, likely
10 more. That the difference between her amortizing
11 principal and full-principal method is that
12 material in the case.

13 We have moved on the application of
14 this method to all of the claims asserted by the
15 FDIC, including Section 11. The FDIC has taken its
16 position -- taken the position in its opposition
17 that this doesn't apply to Section 11. That is not
18 correct.

19 They also have not opposed our
20 Section 12 arguments at all. They've only argued
21 about the TSA. And, therefore, we would deem those
22 points conceded as to Section 11 and Section 12 and
23 unopposed. I have a feeling they may say
24 otherwise, but that is the sort of half motion I
25 was referencing previously.

1 The question of what damages can be
2 put before the jury is a question of law. There's
3 no dispute between the parties on that. We think
4 this is an issue that can be decided now , and
5 there's no reason to wait until trial.

6 So with that , I will start . As Your
7 Honor likely understand s from the briefing , this
8 method -- the full-principal method impacts the way
9 in which Ms. Rutledge calculates prejudgment
10 interest as part of her damages calculat ions.

11 And as it applies to Section 12 and
12 really the TSA , according to the FDIC, her opinion
13 applies interest on the full consideration paid by
14 the FDIC, really Franklin Bank , for the securities
15 without accounting for princip al repayments that
16 were received by Franklin Bank and the FDIC over
17 time.

18 So what that means is in an RMBS
19 situation , if you pay a hundred dollars for a
20 security and then you receive princip al back , that
21 balance , the consideration paid declines . You
22 receive back the monies you paid out . And
23 Ms. Rutledge is applying interest on the hundred
24 dollars rather on the declining balance , which we
25 contend is improper in this context.

1 THE COURT: Now, prejudgment interest
2 is something that -- is this the kind of
3 prejudgment interest that would be something the
4 Court would determine post verdict , if appropriate,
5 right, to factor into a judgment as opposed to
6 something the jury would be deciding , no?

7 MS. SESHENS: I don't -- I think it's
8 part of what the jury would decide because it's
9 part of the statutory damages formula , at least for
10 Section 12 and the TSA because it is -- the damages
11 themselves include the interest component . So it
12 is part of , for example , Ms. Rutledge's opinions
13 and it is part of the rebuttal opinions that
14 address these matters.

15 THE COURT: Anybody want to chime in
16 on that point?

17 MR. YETTER: That's an interesting
18 point, Your Honor . I'm going to argue this point
19 on our behalf . And we have not given that enough
20 thought , but that's a very interesting point
21 because it's pure prejudgment statutory interest
22 under Texas law 6 percent. And obviously that
23 could streamline things a lot for trial.

24 But for the moment if you could hold
25 that thought , we will give it more thought and we

1 will get back to you on that . We're prepared to
2 argue the rest of the points , but that's a very
3 interesting thought.

4 MS. SESHENS: And obviously , Your
5 Honor , we'd be happy to consider that further.
6 It's always been our understanding it would be part
7 of what is presented to the jury. But if there's
8 reason to think that that's otherwise, we obviously
9 would give that some consideration as well.

10 THE COURT: I mean, if it's
11 statutorily part of your damages versus I figure
12 out what your actual damages are and then calculate
13 prejudgment interest, obviously -- I guess those
14 would be two different creatures.

15 I don't know how the -- and I guess
16 you would give the jury -- I'm trying to think how
17 the jury would actually do le that out if it was
18 part of your damages . I guess you would just give
19 them the, This is how I arrived at this figure and
20 it's more persuasive than the other fellow's
21 version, and so you should award this X amount of
22 prejudgment interest , period.

23 MS. SESHENS: I think there's not
24 much dispute. The formulas , obviously , are the
25 formulas . The dispute is really over how you

1 calculate prejudgment interest. I will say that
2 this issue has come up in other cases and it has
3 been decided , for example, as a matter of law in a
4 summary judgment motion . It was applied by the
5 Court in Nomura at trial , and it was part of the
6 damages formula as it was considered by the Courts
7 in those cases.

8 It is not a case where you have a
9 damages finding , and then there's a separate
10 statutory interest component. It is actually baked
11 into the statute , at least for Section 12 in the
12 TSA. There's a different component of this for
13 Section 11, which I'll get to in a moment . But for
14 Section 12 on the TSA, it is part of the statutory
15 formula. And it's the same for both.

16 THE COURT: Okay.

17 MS. SESHENS: So our position , as
18 I've just articulated , is that Ms. Rutledge cannot
19 be permitted to opine to the jury on her
20 full-principal method because it basically double
21 rewards the FDIC by paying interest on princip al
22 that was already received.

23 The FDIC does not cite a single case
24 to support its position. And by contrast , the only
25 two courts in RMBS cases of which Morgan Stanley is

1 aware that have considered the issue have supported
2 Morgan Stanley's position. That's the Schwab case
3 that we've cited in our papers in California and
4 the Nomura case, the FHFA case that Mr. Grais and I
5 both referenced earlier today.

6 In both of those instances, the Court
7 held that the prejudgment interest had to be
8 applied to a declining principal balance and could
9 not be on full principal. In Nomura, the Plaintiff
10 didn't even advance a full-principal methodology,
11 and the Court applied the -- effectively, the
12 amortizing principal methodology, which is
13 Ms. Rutledge's other set of opinions.

14 Federal courts that have interpreted
15 Section 12's damages provisions over time are in
16 accord with those holdings. The Loftsgaarden case
17 and the Johns Hopkins cases that we've cited all
18 reflect that you get an offset in effect for
19 consideration repaid when it is a declining balance
20 security such as an RMBS. Or in those cases they
21 were different types of securities.

22 But on the theory that Section 12 and
23 the TSA are recessionary statutes, which are
24 intended to put the investor back in the position
25 he or she was in initially, that's the only way

1 that you can do it without providing the investor
2 with a windfall.

3 Now, the FDIC contends that there is
4 no unjustified windfall here. That it's
5 appropriate to essentially double recover because
6 the statutory purposes of the TSA are furthered by
7 that. We respectfully disagree.

8 The statutory purposes that they've
9 identified are not unique. And there is nothing
10 that the FDIC has pointed out to show why or how
11 those purposes aren't furthered by the amortizing
12 principal method and by the ability to bring a
13 private cause of action and by the ability to have
14 a strict liability claim.

15 For those reasons, prejudgment
16 interest is not intended to punish a Defendant. It
17 is not intended to over compensate a Plaintiff. It
18 is intended to restore the Plaintiff to the
19 position he or she would have been in had the
20 transaction not happened. And there's nothing that
21 the FDIC identifies that is to the contrary insofar
22 as amortizing principal should apply.

23 With Section 11, the application of
24 the methodology is a bit different. There is no
25 prejudgment interest there. The formula, in

1 essence , is the price paid minus the price received
2 upon a disposition. And there the price paid is
3 analogous to the consideration paid .

4 And Ms. Rutledge again has offered
5 two opinions. She herself has recognized that
6 there's a lack of clarity -- that is what she has
7 said -- in how interest should be calculated . And
8 she did the full-principal method where she applied
9 the damages formula without accounting for
10 principal repayments and she did an amortizing
11 method where she does account for principal
12 repayments.

13 And the reason that principal
14 repayments should be deducted from the price paid
15 for Section 11 is exactly the same as the reason it
16 should be deducted from the consideration paid for
17 Section 12 . To hold otherwise would provide the
18 FDIC with Section 11 damages that would include
19 monies already repaid on the securities . Again, a
20 double recovery.

21 Section 11 , like Section 12 in the
22 TSA, are compensatory in nature . They are not
23 punitive . And there 's nothing that the FDIC has
24 identified that supports application of the
25 full-principal method to Section 11 damages as

1 well.

2 THE COURT: Response?

3 MR. YETTER: Yes , Your Honor . Paul
4 Yetter for the FDIC. We should have a short ,
5 little presentation , Your Honor, that will help us
6 to go through , if the Court allows me ?

7 THE COURT: Sure.

8 MR. YETTER: And it should be on your
9 screen. We can probably just do it on the screen ,
10 Judge, if that works , because I think all the
11 lawyers will have it on their screens.

12 THE COURT: Okay.

13 MR. YETTER: All right , Your Honor .
14 So I've only been given permission to talk about
15 one thing today , Judge, in the interest of safety
16 for my client. So -- hold on.

17 Really where we're at on this issue ,
18 this issue of the damages , is that Morgan Stanley
19 is essentially calling in to issue the Texas
20 statute , the Securities Act.

21 THE COURT: I'm not -- I don't see --
22 am I supposed to be seeing something ?

23 MR. YETTER: Yeah, you should be
24 seeing something on your screen , Judge. It doesn't
25 look like you are . Maybe we can -- there we go.

1 See if that works.

2 (Discussion off the record)

3 THE COURT: There we go .

4 MR. YETTER: There we go.

5 THE COURT: I'm sorry , one more time.

6 MR. YETTER: Sure. Judge, the
7 complaints that Morgan Stanley has basically go to the
8 -- to the actual language of the legislature in the
9 Texas Securities Act. So the language of the statute
10 is very clear. It adds interest. It says -- it's a
11 very simple formula . It adds interest to the
12 compensation paid for the security.

13 So you take the security the day you
14 bought it , you figure out how much you paid for it,
15 you add interest at the statutory rate until the day
16 of trial -- or the day of the verdict. Then from that
17 amount , you subtract certain things. You subtract all
18 the income you've got on the security, which would be
19 both your interest payments and your princip al repaid,
20 and you subtract your sale proceeds.

21 So you start with the -- how much you
22 paid plus interest, and you subtract income , which is
23 interest plus -- that you got paid and principal
24 repaid, and then sale proceeds . That's what the
25 statute literally says.

1 They're saying, Nope, for this kind
2 of security -- and that applies to all sorts of
3 securities, Judge. Life insurance policies, all
4 kinds of securities. What Morgan Stanley is saying
5 for this kind of security for RMBS -- or RMBSs,
6 that you have to have a different formula.

7 And so if you see the first bullet,
8 it says what their -- what Morgan Stanley is
9 basically saying is the statutory formula shouldn't
10 be the actual compensation you paid, and then you
11 add interest. It should be the actual compensation
12 you paid less income you receive later, and then
13 you add interest.

14 Now, that's not what the statute
15 says; but that's what they're asking for, Your
16 Honor. That's their amortizing principal basis.
17 And they're saying, Oh, but if you don't do that,
18 it's too harsh on people that violate the law with
19 regard to residential mortgage-backed securities.
20 And so what they're really proposing is a net
21 compensation paid, then you add interest.

22 Now, here --

23 THE COURT: Didn't you start off by
24 saying that you calculated -- I thought you started
25 it off by saying that you calculated at net of --

1 MR. YETTER: No, you don't. Okay.

2 So the statute says --

3 THE COURT: -- you made money on the
4 security. You subtract -- you subtracted several
5 things.

6 MR. YETTER: The whole p oint, Your
7 Honor, is when do you add interest?

8 And what the statute says is you take
9 the purchase price, then you add interest from the
10 day of the purchase to the day of the verdict.
11 Then you subtract.

12 THE COURT: Oh, okay. So your
13 subtraction is after you've added the interest.

14 MR. YETTER: That's what the statute
15 says. Now, what Morgan Stanley wants to say is --

16 THE COURT: Get the net first, and
17 then calculate the interest.

18 MR. YETTER: Exactly. And that's wh y
19 there's a difference.

20 THE COURT: Yes.

21 MR. YETTER: Because if you take out
22 the income before you add the interest, then you're
23 going to have a lesser amount .

24 THE COURT: That's like an attorney
25 taking a fee on a gross recovery as opposed to the

1 net recovery.

2 MR. YETTER: Very much like that. So
3 here what the statute says , for very good reasons ,
4 it says take the purchase price , then add the
5 interest , and then deduct your income and your
6 sales proceeds.

7 And there's three reasons . And I
8 can, hopefully , Judge , quickly go through . So the
9 first reason , number one . It's a very simple --
10 it's a very simple formula . And the Texas Supreme
11 Court through the pattern jury charge says to trial
12 judges , Use that formula when you charge the jury .
13 And the formula is total purchase price plus
14 interest, then you take off your income and your
15 sales proceeds. And that's what it is right here .

16 The big dispute we have with Morgan
17 Stanley is they want to take the income off twice
18 because they want to take the purchase price, then
19 subtract the income and add interest . And then
20 they want to take the result and subtract income
21 again the second time . And subtracting income
22 twice is not what the statute says.

23 So, Your Honor, what the PJC tells
24 trial courts to do is use the language of the
25 statute. So when we charge this jury , unless your

1 idea of having the interest --

2 THE COURT: Be a judgment decision as
3 opposed to a jury decision .

4 MR. YETTER: Yes. That's an
5 interesting idea. I'm not saying -- I can't
6 comment. Smarter people than I are going to be
7 thinking about that overnight, Your Honor.

8 Then it's going to be -- the jury is
9 going to have to decide this and you're going to
10 give them the actual language. And unless we
11 change the language, which is what Morgan Stanley
12 is saying we have to do, the jury's going to decide
13 the way the statute says.

14 Okay. Second point. So this is --
15 the first point is that's what the statute says and
16 that's what the PJC tells us to do. And on that
17 point, Your Honor, both sides before -- actually in
18 February, exchanged jury charges. And not
19 surprisingly, both sides have the jury charge that
20 says exactly this. It says the -- it tracks the
21 language of the statute.

22 So you have full purchase price plus
23 interest, and then you subtract income and sales
24 proceeds. So that's what both sides did.

25 And, Your Honor, I can give that to

1 you if you're interested. But I'll represent to
2 the Court that Morgan Stanley's and the FDIC's
3 proposed jury charges exchanged on February the
4 20th, 2015, say exactly what I just said.

5 Okay. Second point. The second
6 point is that the text of the statute requires us .
7 And there's lots of good reasons for that. So what
8 the text says , Both sides agree that principal that
9 is repaid is called -- is income.

10 And the reason I'm focusing on the
11 language, Your Honor, is because the Texas
12 Securities Act has compensation and income, two
13 different words in two different parts. They don't
14 mean the same thing.

15 So compensation paid is essentially
16 the purchase price, what you paid for the security.
17 Then you add interest. Then second step, you take
18 out the income, which is both the interest you
19 actually earned and the repaid principal and the
20 sales proceeds. So that's the second step.

21 Both experts' reports , Your Honor,
22 call repaid principal income. It can't be the same
23 thing. It can't be income and compensation paid
24 under the statute because , as the Court knows , you
25 don't -- you can't do that . You can't have two

1 words that mean the same thing or else the
2 legislature -- and, of course, the legislature
3 could never have done something irrational or
4 unreasonable. Not our legislature. So we,
5 obviously, have to -- can't do it -- can't
6 interpret it that way.

7 So the bottom line is, Your Honor,
8 the statute says income is subtracted after you add
9 interest in step two, not in step one. In fact,
10 what we've heard from Morgan Stanley -- and I think
11 they've done it very effectively -- they talked
12 about, Oh, it's a windfall and they're getting
13 double recovery.

14 And, in fact, it's not. It's working
15 just like the legislature said. First you have the
16 amount you paid plus interest. And step two is
17 taking out the income. What they would like to do,
18 Morgan Stanley, is take out income twice on both
19 sides of the equation.

20 What they really are saying --

21 THE COURT: I'm sorry, I missed that
22 part. How is what they're arguing taking out
23 income twice?

24 MR. YETTER: Okay. Because step one
25 is consideration paid plus interest under the

1 statute . And step two is then you take out income.
2 You subtract income , which is interest , repaid
3 principal and sales proceeds.

4 What they want to do is also take out
5 repaid principal from step one before you add
6 interest. And so they would be taking out twice.

7 THE COURT: All right . It sounds to
8 me like what they 're saying is he would take it out
9 at the beginning , which then would ultimately
10 reduce the base amount on which the interest is
11 calculated.

12 MR. YETTER: True. But they're
13 taking out income on both sides of the equation.
14 They're taking out the prepaid principal on step
15 one .

16 THE COURT: Right.

17 MR. YETTER: And then the income and
18 the sales proceeds -- I'm sorry , the interest and
19 the sales proceeds on step t wo. So they want to
20 have income on both sides of this equation when the
21 statute says it's only in step two.

22 THE COURT: Okay. Keep going . What
23 else?

24 MR. YETTER: All right. So what they
25 really are saying , Your Honor , is they 're saying

1 for this type of security -- and, again, the Texas
2 Securities Act covers all types of securities --
3 for this type of security that is called -- that
4 they call an amortizing security where you get paid
5 your principal along the way, you have to have a
6 different rule.

7 And the Texas Supreme Court has said
8 no, you don't do that. They have one securities
9 act. It may be better suited for certain
10 securities than others, but it's one rule. The
11 legislature has that prerogative.

12 Here, Morgan Stanley wants to say you
13 have to have a different damage calculation because
14 the nature of the security they're claiming is
15 different. And they cite to two cases, Nomura and
16 Schwab. And with all due respect to very capable
17 counsel, neither case held, as I believe the Court
18 was told, that the amortizing method is the legally
19 required method. And I'll explain briefly why.

20 Schwab wasn't even a Texas Securities
21 Act case. It was a California statute. It has
22 different wording in significant ways. It wasn't
23 even -- and they ruled on summary judgment that the
24 different California statute, which apparently has
25 different legislative intents, has a different way

1 of doing things.

2 That's not what the Texas Securities
3 Act says. In a very specific way there's a -- in
4 the Texas Securities Act, very briefly, Judge, it
5 says compensation paid plus interest thereon.
6 "Thereon" being compensation paid.

7 The California act doesn't say that.
8 It doesn't have the word "thereon." So that
9 California Judge on summary judgment made a
10 different ruling that we don't believe has anything
11 to do -- that in any way requires the Court to make
12 a ruling one way or the other in this case.

13 Nomura, which is a Federal court
14 case, both parties agreed to apply this amortizing
15 principal. The Judge never made a ruling one way
16 or the other. She simply said, This is what the
17 Plaintiff and the Defendant agree upon in the
18 approach and I'm going to enforce it. So there was
19 no ruling either way.

20 We're not -- we don't believe that
21 there's any case under the Texas Securities Act or
22 specifically under the Section 12 that deals with
23 this issue foursquare. But we think in this case,
24 Your Honor, the statute is what the Court's going
25 to follow. The PJC is what the Court is going to

1 charge the jury on . And the purposes of the
2 statute is what you're going to be guided by, which
3 is point three.

4 The purposes of this statute -- I'm
5 on Slide 5, Judge.

6 THE REPORTER: Going to what?

7 THE COURT: " I'm on Slide 5," he
8 said.

9 MR. YETTER: I'm sorry , let me slow
10 down.

11 The purposes of this statute , which
12 are absolutely clear because the Supreme Court
13 eight years ago in 2007 said , Our state 's blue sky
14 laws , which is what this statute is a part of , have
15 three -- and I'm quoting ; this is a Citizens
16 Insurance case -- quote , "long-standing purposes ."
17 This is our Texas Supreme Court.

18 THE COURT: You know what ? With all
19 due respect , I've read the slide and I get -- the
20 statute is there to encourage people to comply with
21 the blue sky laws.

22 MR. YETTER: Exactly. And so what
23 this -- what Morgan Stanley is saying is if it
24 slightly -- if it is not precisely compensatory ,
25 then it can't survive. Well , in fact , the Court

1 has said it needs to incentivize and it needs to
2 deter.

3 And I'd make one other point, Your
4 Honor, that's not actually reflected on this
5 statute -- on this slide. Is that the Texas
6 legislature basically decided that when someone
7 misrepresents, causes -- makes misrepresentations
8 in selling a security, the legislature is going to
9 come in and compensate that victimized investor by
10 awarding them the Texas statutory prejudgment
11 interest amount, which at least in today's world
12 can be far more than the agreed interest that they
13 thought they were going to get on their security.

14 So, for example, here when securities
15 are purchased and the interest rate is, perhaps in
16 many of these, much less than 6 percent, the
17 Supreme Courts -- I mean, the legislature said
18 you're going to get 6 percent the entire life of
19 that security.

20 Now, Morgan Stanley could just as
21 easily be in this courtroom saying, Well, that's
22 overcompensatory. And so that's inconsistent. And
23 so they could only get the interest that they
24 thought they were going to get when they bought the
25 security.

1 The legislature's totally entitled to
2 do that. They're totally entitled to encourage
3 compliance and deter violations, and they're
4 entitled to create incentives.

5 So concluding, Your Honor, actual --
6 we actually think that the approach we're using is
7 the actual compensation paid approach plus
8 interest, and then deduct the income. That's what
9 we believe the statute requires. That's what we
10 believe you're going to -- the Court's going to
11 charge. And there are lots of good reasons to do
12 that.

13 THE COURT: Now, whether I make that
14 decision or the jury makes that decision, I think it's
15 going to be a readily ascertainable number either way .
16 Just math. That is something that we could fix post
17 verdict fairly easily.

18 MR. YETTER: Absolutely. And if you
19 don't want to have to -- if we're right or even if
20 they're right, it will all come out in the trial . And
21 afterwards you can take a fresh look if you want to
22 take a fresh look at it, Your Honor. Or maybe even
23 we'll take the approach that you'll apply the
24 interest. And that can happen all after trial, but we
25 need to have -- after the verdict, but we need to have

1 the evidence before the jury.

2 THE COURT: Now, but this is a motion in
3 limine point. So they are arguing that there
4 shouldn't even be testimony at the trial --

5 MR. YETTER: That's what they're
6 arguing.

7 THE COURT: -- about the -- your
8 calculation.

9 MR. YETTER: How do we get a ruling from
10 the jury if we don't have the evidence in the trial
11 record? Unless we want to do this again . And I don't
12 think anybody wants to try this case again, Your
13 Honor. We have to have the evidence in the record .

14 Again, as you said , either you can apply
15 this as a matter of law afterwards if that's what we
16 consider -- you consider to be appropriate or you can
17 always fix it in a post -judgment motion.

18 THE COURT: Right . So how is this -- so
19 why would this be appropriately a limine point?
20 Unless you're -- I mean, you're really asking me to
21 make a legal decision , sort of a summary judgment --
22 or a Rule 166 motion to decide something as a matter
23 of law.

24 MS. SESHENS: What we think , Your Honor ,
25 contrary to Mr. Yetter 's portrayal of this whole

1 issue, that you have to decide it and you have to
2 decide it before anything goes before the jury for
3 this reason. Mr. Yetter has characterized this whole
4 amortizing principal methodology as Morgan Stanley's.

5 To be clear, Morgan Stanley does not
6 think there are damages in this case. We have not put
7 forth an affirmative damages expert. We have
8 responded to the FDIC's Ms. Rutledge, the FDIC's own
9 expert. All these criticisms of the amortizing
10 methodology, which are incorrect and I'll get to those
11 in a moment, are Ms. Rutledge's method.

12 And the reason we need a motion in
13 limine ruling now is that she otherwise has two
14 opinions. She has damages opinions that vary in the
15 range of 25 to 30 million dollars. And the jury can't
16 decide which opinion is legally tenable. The Court
17 has to make that determination.

18 It can be -- we think it would be clear
19 legal error for the jury to decide which methodology
20 under the statute is appropriate. And the jury cannot
21 be left to choose between Ms. Rutledge's two opinions.

22 So unless they are pulling one, in which
23 case we challenge it on different grounds,
24 Ms. Rutledge has put forth the amortizing principal
25 methodology. Ms. Rutledge has backed out principal

1 repayments from the amount on which she has calculated
2 prejudgment interest. She has not backed out income
3 twice. That is not what is going on here.

4 But to be clear , we do not think that
5 this is an issue that can go to the jury. How would
6 the jury decide whether it's her amortizing principal
7 method or her full-principal method? It's clearly a
8 legal question of how the statutes work .

9 MR. YETTER: I'm happy to respond to
10 that. I don't want to interrupt her presentation ,
11 Your Honor , but if you 'd like a response to that , I'll
12 be happy to.

13 THE COURT: Are you finished --

14 MS. SESHENS: I just want to clarify a
15 few points, Your Honor. That is why this jury charge
16 issue, to our mind , is a total red herring , because we
17 don't think this opinion can even go to the jury.
18 Nobody is saying the charge shouldn't reflect what the
19 statutes say. The point is the jury cannot make this
20 determination. It is a legal question that has to be
21 decided by the Court.

22 Now, in terms of how Mr. Yetter has
23 described Ms. Rutledge's methodology, we think that
24 there were some errors in that description that I just
25 wanted to clarify . I think Your Honor actually picked

1 up on it . But it is not the case that income is being
2 backed out twice.

3 To be clear , what Ms. Rutledge has done
4 is taken in her amortizing method the principal, the
5 consideration paid, minus interest . The way she
6 determines the interest is to reduce the consideration
7 paid by principal repayment and calculate interest on
8 that amount . So it's consideration paid, minus
9 principal repayments, interest calculated on that
10 declining balance. Those two are added together.

11 Then she takes out -- and this is
12 Ms. Rutledge , this is the FDIC's expert . She then
13 takes out income, which she defines as income and
14 principal repayments . And so that is how she takes
15 those out at the end of the statute.

16 The Nomura case , for example, which is a
17 Section 12 case where the Court awarded Section 12
18 damages using the amortizing principal method, the
19 Court took the income out from the consideration paid ,
20 and then didn't take it out -- I'm sorry , took the
21 principal payments out from consideration paid , and
22 then only took income out at the end. But
23 mathematically it's the same thing .

24 But there's no double counting of
25 income . That is the point I want to make clear to

1 Your Honor. I think Your Honor understood that by
2 your questions . It is only the basis on which
3 prejudgment interest is being calculated that is at
4 issue.

5 Just two quick points, Your Honor.

6 THE COURT: Does anybody have like a
7 ready -- or do the reports themselves have the
8 ready, the formula -- an actual display of the
9 formula that they are using so I can see where --
10 see what that actually look s like mathematically?

11 MS. SESHENS: Yes , I believe -- I
12 don't want to speak for the FDIC , but I think both
13 damages experts have put into numbers how these
14 things work. Our expert , just so Your Honor knows ,
15 simply follow ed Ms. Rutledge's methodology . He did
16 not opine on whether that was proper or not. H e
17 just said if you take her methodology , here's how
18 the numbers change . But there are actual numeric
19 calculations that reflect how the numbers are
20 impacted by this.

21 THE COURT: So, I mean, I agree with
22 you that the jury is not going to be the one that
23 decides which methodology is used, I don't think.
24 I mean, that doesn't make any sense. I don't know
25 -- maybe Mr. Yetter can speak to this as well , but

1 I don't know that we're asking them to make that
2 decision.

3 We're asking them -- I guess what I'm
4 saying is if we let Ms. Rutledge testify as she
5 proposes, then she would be saying this is what the
6 damages are and whatever that damage number is at
7 the end of the day, if the jury agreed with her,
8 that would per se include whatever prejudgment
9 interest they were entitled to. And if I bless
10 that, then that would be the end of it.

11 Versus her opinion -- her giving an
12 opinion as to these are what the actual damages
13 are, and then we ultimately conclude the right
14 methodology is to -- at the end of the trial, then
15 figure out which basis to -- which manner is the
16 correct way to calculate the prejudgment interest.

17 MS. SESHENS: I think, Your Honor,
18 given the statutory language, it would seem it has
19 to be the former. It's part of the statutory
20 formula. It's not like you assess, for example,
21 contractual damages or tort damages, you know, and
22 then there's discretionary statutory interest where
23 there's mandatory statutory interest. And the
24 Court can do the simple math.

25 This is actually a statutory

1 interpretation question . How does this statute
2 work as a legal matter ?

3 Putting it into numbers is not so
4 hard once you make that determination. But that's
5 the question we 've put before the Court now . It's
6 the question we think the Court has to decide
7 before trial because we don't think the jury can
8 make that determination.

9 (Sotto voce discussion between
10 counsel)

11 MS. SESHENS: Your Honor , my esteemed
12 colleague just made the excellent point that when
13 you think about from the charge , you know , they're
14 not -- the jury is not going to be asked to
15 calculate the different components of the damages
16 formula . There's going to be a damages number
17 that's been put before them and they're going to
18 pick it or they're not.

19 THE COURT: Or it's going to be a
20 blank .

21 MS. SESHENS: Right . And so it's not
22 going to be the case that they're going to go and
23 pick and choose and figure out how the statute
24 actually works . They're going to listen to the
25 opinions --

1 THE COURT: No . I think we're saying
2 the same thing in part. In that we're never going
3 to ask the jury to decide , Do you do it this way or
4 do you do it that way ?

5 It's going to be the experts ought to
6 be able to opine this is what the damages are. But
7 the Court 's going to decide -- the Court will have
8 to decide whether it's an issue of -- the Court
9 will decide the -- I guess what we're saying is if
10 I agree with you -- or whoever I agree with , the
11 other way is simply not -- the other analysis is
12 just not relevant because it's a legal
13 determination.

14 MS. SESHENS: That 's correct, Your
15 Honor. And that is how we see this issue very
16 clearly. And I would just note before I sit down
17 and yield the floor to Mr. Yetter that you didn't
18 hear the FDIC say anything at all about Section 11 .
19 Their whole presentation is about the TSA. They
20 have no argument in response to Section 11 .

21 They've said nothing about
22 Section 12. Section 12's language about
23 consideration paid for the security plus interest
24 thereon is exactly the same as the TSA. You can't
25 reconcile their position . If it's amortizing

1 principal under Section 12 , it has to be amortizing
2 principal under the TSA . There's nothing in the
3 statute or in its purpose that says otherwise.

4 Thank you , Your Honor.

5 THE COURT: All right. Very briefly .
6 Just for the record , it's 4:39 . So I don't know
7 how much further we're going to get.

8 MR. YETTER: Okay . Let's just spend
9 five more minutes on this , Judge. What is your --
10 do you have any -- what is the question that you
11 need answered?

12 As a matter of evidence , the evidence
13 needs to come into the trial for the jury to make a
14 determination to answer the question. The question
15 that the FDIC has said -- I'm sorry , that Morgan
16 Stanley has said , the FDIC is entitled to recover
17 the consideration paid for the certificate plus
18 interest thereon at the legal rate from the date of
19 payment . That's step one. Comma, less the greater
20 of. And then they go into income, the value of the
21 certificate at the time they sold it and the actual
22 consideration received for the certificate . Dot,
23 dot, dot.

24 So the point is they have -- Morgan
25 Stanley has in their jury charge exactly the same

1 formula that we have. Now , until the Court
2 suggested that maybe the Court can decide this
3 after the verdict , we assumed like in every other
4 securities case the jury is just going to apply
5 that simple formula : Consideration plus interest ,
6 minus income . And that's , we think , very much
7 within the jury's province. They just have to have
8 evidence.

9 Now, our expert has given two
10 approaches knowing , of course , that Morgan Stanley ,
11 there's lots of these cases . We know their
12 approach. She said , Well, if they are convincing
13 and you take their approach, this is how you
14 calculate it. Our approach , we believe , is the
15 actual compensation approach and this is how you
16 calculate it . There's nothing inconsistent with
17 the fact that she's given numbers for both.
18 Experts do that a lot.

19 So our point basically , Your Honor , is
20 this is not a motion in limine issue. At best , maybe
21 this is a charge issue that the Court deals with on
22 the charge . But the evidence has got to come into the
23 trial for the jury to be able to decide.

24 THE COURT: I don't think it can be a
25 charge thing because I think I have to make a

1 decision as to the right methodology legally
2 pretrial , it sounds to me. Because otherwise the
3 evidence won't be in front of the jury if I decide
4 that it's --

5 MR. YETTER: So --

6 THE COURT: -- that it's -- well,
7 either way, I guess.

8 MR. YETTER: Our position , Your
9 Honor, our expert's pr epared to give both numbers ,
10 both approaches.

11 MS. SESHENS: And as I said , Your
12 Honor, we think that's legally untenable.

13 MR. YETTER: It happens in trials all
14 the time where you have a more complicated trial
15 where there's some valuation issue and there is an
16 issue that the jury may accept this particular fact
17 over that fact and a damage expert gives alternate
18 damage theories . Frankly , it's happened in every
19 complicated case --

20 THE COURT: Alternate damage theories
21 are if you've got different theories that all fit
22 under the same legal analysis. But here I think
23 it's a legal question first that will direct the
24 nature of the expert's testimony.

25 MR. YETTER: I hear wh ere the Court's

1 coming from. Obviously you 've heard our arguments
2 why as a legal matter the approach -- the actual
3 compensation approach is what the statute says is
4 what we think the Court is going to charge the
5 jury. So the Morgan Stanley position is going to
6 have to require a change in the language of the
7 statute or a change in the charge to the jury.

8 But, again, we submit that you could
9 deal with this on -- at the jury charge or at
10 post-judgment rulings . But if the Court's inclined
11 to make a decision earlier than that , we're
12 certainly prepared to --

13 THE COURT: I think that would be
14 tough for the jury because it's a -- what they
15 would hear is , Here's one mathematical formula ,
16 here's another mathematical formula. But then how
17 do we instruct them that this is how the Court
18 ruled ultimately in -- in other words , how does the
19 question change in the jury charge depend ing on how
20 I make a ruling, say at the charge conference , that
21 would direct the jury as to which approach to take ?
22 That's not clear to me.

23 MR. YETTER: So for what it's worth ,
24 Your Honor , we're comfortable if the Court wants to
25 make a decision now . We think the statute is

1 absolutely clear for the reasons that we've already
2 given to the Court . We think the full compensation
3 -- actual compensation approach is correct.

4 THE COURT: Give you another 30
5 seconds if you want.

6 MS. SESHENS: Certainly, Your Honor .
7 Thank you .

8 You've obviously heard us on the fact
9 that we think it 's a legal issue. I would just
10 note in closing that when Your Honor looks at this
11 issue , it is a legal issue. There is not a single
12 case that the FDIC has cited to you that supports
13 the full-principal method . And all of the cases
14 that have been decided in this context and even in
15 other context s have supported the amortizing
16 principal method. We , therefore , think there is no
17 support for the FDIC's position.

18 Thank you, Your Honor.

19 THE COURT: Tell me one more time ,
20 Mr. Yetter , where should I read -- where should I
21 look for this? You just say it's the plain
22 language of the TSA.

23 MR. YETTER: So there is no Texas
24 case on this statute in this context, Your Honor.
25 There is a statute that has a simple formula. If

1 the Court would like , we can -- I tried to do -- I
2 tried to kind of distill all this down i nto our
3 presentation . I'm happy to give you a hard copy of
4 that. I think we may even have it handy.

5 But the bottom line is , as the
6 statute says , it's a two -step process. We're
7 handing up to the Court right now a copy .

8 May I approach, Your Honor?

9 THE COURT: Sure.

10 MR. YETTER: I know the Court doesn't
11 like paper , but I thought this might be a little
12 helpful. But the bottom line is the statute has a
13 clear two-step formula . To the extent t hat Morgan
14 Stanley is correct , they have to change the formula
15 for these types of securities.

16 That's not what the law says.
17 There's one securit ies act. There's one form ula.
18 It is a two -step formula where income is take n out
19 in the second step. Their expert calls repaid
20 principal income, which is what it is ; and it
21 doesn't come out of the first step.

22 And that's our position, Your Honor.
23 I know you can't get any more certain than the
24 clear words of our state legislature in every case.
25 This is one where actually I think it is pretty

1 clear , Your Honor .

2 MS. SESHENS: Your Honor , just one --

3 MR. YETTER: Thank you for the time
4 on this issue.

5 MS. SESHENS: -- one point to
6 conclude. Well, perhaps really two.

7 We fundamentally disagree that the
8 jury charge would have to be changed at all. The
9 statute is what the statute is. The question
10 before the Court is how does one interpret that
11 statute?

12 The jury is not being asked to do
13 that. The jury will be presented with evidence
14 that is consistent with the interpretation that the
15 Court determines.

16 The second point I would note for
17 Your Honor is the Nomura case that we 've talked
18 about had a Section 12 claim, but also had a
19 Virginia blue sky claim , which is the TSA , if you
20 will, of Virginia that also contain ed the
21 consideration paid plus interest thereon from the
22 date of payment language . And the Court applied ,
23 again, the amortizing principal methodology.

24 So while Texas perhaps has n't
25 grappled with this issue , other courts have . The

1 California statute in Schwab is not different . It
2 has different language . It is not substantively
3 different . And the Nomura case dealt both with
4 Section 12 and also with blue sky laws.

5 Thank you, Your Honor.

6 THE COURT: Okay . I think it's fair
7 for me to look at that case law now that I have a
8 better grasp of what the argument is about on this
9 issue.

10 MS. SESHENS: Your Honor , on that
11 note, one thing . Would it be helpful to Your
12 Honor, and both sides could do this , if we provided
13 you with the cases so that you have them
14 accessible? Or do you have them handy?

15 We realize we should have thought
16 about this before we came in . There's a lot of
17 cases we cite , there's a lot of motions . To the
18 extent it's helpful , I'm sure -- I don't want to
19 speak for the FDIC , but I'm sure we'd all be happy
20 to send a drive over with everything electronically
21 if that would aid the Court.

22 THE COURT: You know what ? It's just
23 as easy for me to find them on Westlaw as long as
24 they're cited in the papers.

25 MS. SESHENS: Okay . As long as

1 that's easy enough for you , that's fine. We just
2 wanted to offer it.

3 THE COURT: All right . Let's see if
4 we can knock out one more real quick. Is there a
5 short one that we could skip to maybe , or two or
6 three?

7 MS. SESHENS: Hold on one second,
8 Your Honor.

9 THE COURT: How about use of a smart
10 board at trial , is that --

11 (Laughing)

12 MR. YETTER: So , Your Honor, I'm
13 going to withdraw that because we've tried it and
14 the courtrooms are just not set up effectively.
15 You have to basically kind of -- you can't really
16 fit it in here very easily and you have to kind of
17 do it over the bar. So we won't use the smart
18 board. We have good technology in the courtroom.

19 THE COURT: All right. How about
20 application of the standing order of limine ,
21 anybody opposed to that?

22 MR. YETTER: We're good with that
23 one, too, Judge.

24 THE COURT: Well --

25 MR. YETTER: Is there something there

1 that we have a problem with?

2 MR. HOLTON: Well , Your Honor , Mark
3 Holton.

4 THE COURT: How are you? I haven't
5 talked to you in a while. Are you doing okay?

6 MR. HOLTON: Fine, sir. Thank you
7 very much.

8 In that regard , we do not have an
9 objection to apply application of the limine order .
10 Of course, we do perhaps have a disagreement with
11 Morgan Stanley about whether that in limine order
12 precludes the admission of certain evidence that we
13 think is not subject to it , but which they have
14 suggested is.

15 I'm happy to go into that. It's
16 their motion. It might be one to knock out
17 quickly. I don't know . It's a rather discrete
18 one, the Bank of America settlement document. But
19 that's our qualification on the in limine order.

20 THE COURT: Hold on one second . I'm
21 sorry, so what's the settlement document that we're
22 talking about?

23 MR. HOLTON: Yes, sir . Your Honor,
24 this is a motion by Morgan Stanley to preclude the
25 admission into evidence of a settlement agreement

1 between Countrywide and the Department of Justice
2 resolving claims relating to RMBS .

3 And I do need to give a little bit of
4 background here, Your Honor. You've heard argument
5 today about Dr. James . And Ms. Seshens noted that
6 one of the things that Dr. James tries to do -- and
7 we acknowledge it's related to loss causation , as I
8 think Your Honor has recognized -- is to say that
9 he has compared the loans that our underwriter
10 found to be defective against a controlled set of
11 loans and says , When I do that comparison , the
12 performance is the same in both. So these
13 underwriting defects didn't cause the loss.

14 THE COURT: Right.

15 MR. HOLTON: Well , obviously , Judge ,
16 that only works if the controlled set of loans
17 doesn't have the defects associated with it. And
18 Dr. James fails to make any showing that those
19 loans are free of defects. And the loans that he
20 chose were loans sold by Countrywide -- excuse me ,
21 loans sold to the GSE s Fannie Mae and Freddie Mac ,
22 which we made reference to before.

23 And we -- Dr. James has not made any
24 effort to actually show that that controlled set of
25 loans is free of the defects that our underwriter

1 found in the loans at issue here.

2 But we're trying to go a step beyond
3 that, as we think we're entitled to, Your Honor, as
4 a matter of rebuttal evidence. As Dr. James
5 admits, his controlled set of loans almost
6 certainly contains a lot of loans from Countrywide
7 because Countrywide was the biggest seller of loans
8 to the GSEs during this relevant time period.

9 And that's where the settlement
10 agreement comes in, Your Honor. Countrywide
11 admitted in its settlement agreement with the
12 Department of Justice that it sold defective loans
13 to the GSEs during the relevant time period. So
14 not only has Dr. James failed to do anything to
15 demonstrate that his loans set -- his controlled
16 set is free of defect, we actually have good
17 evidence that it's not.

18 And that's where the agreement
19 between the Department of Justice and Bank of
20 America, which of course now owns Countrywide,
21 comes in because it was in that agreement, an annex
22 to that agreement, where Countrywide, Bank of
23 America explicitly admitted that we sold defective
24 loans in violation of -- we made misrepresentations
25 and sold defective loans to the GSEs.

1 These are the very loans that are in
2 the control set that Dr. James is using to
3 allegedly show no loss causation. I think it
4 obviously blows up that analysis entirely. Now,
5 they said --

6 THE COURT: And so the limine point
7 dealing with settlement agreements is what you're
8 addressing?

9 MR. HOLTON: Yes, sir. Because
10 they've -- I don't -- again, don't want --
11 Ms. Seshens is well able to speak for herself, but
12 as I understand the argument, they've said, Well,
13 as a matter of sort of policy or what have you,
14 it's a settlement agreement, and so that shouldn't
15 come in.

16 And, of course, our argument is,
17 Judge, well, it's not a settlement agreement
18 involving Morgan Stanley. We're not suggesting
19 that it is. It's a settlement agreement involving
20 Bank of America.

21 THE COURT: So you say it has some
22 relevance. So to the extent they're seeking to
23 exclude it simply under 408 as a settlement
24 agreement, that shouldn't happen?

25 MR. BURNOVSKI: Your Honor, if I may?

1 It is our motion . I'm happy to -- I don't want to
2 interrupt , but I'm happy to explain sort of the
3 bases for the motion , if that would be helpful .

4 THE COURT: Sure. Real quick.

5 THE REPORTER: What is your name ?

6 MR. BURNOVSKI: Brian Burnovski.

7 THE REPORTER: Okay. Thank you.

8 THE COURT: Spell the last name.

9 MR. BURNOVSKI: B-u-r-n-o-v-s-k-i .

10 THE COURT: Wow, I would have gotten
11 every part of that wrong .

12 MR. BURNOVSKI: I t's not an easy one ,
13 Your Honor .

14 So what the FDIC is seek ing to admit ,
15 Your Honor , is a settle ment agreement by Bank of
16 America with a number of government entities ,
17 including the U .S. Government and various state
18 attorney general , as well as a statement of facts
19 that was ended to the agreement.

20 And just to -- as a preliminary
21 matter, just to clear up a couple of things that
22 Mr. Holton said. Contrary to the FDIC's
23 characterization of the settlement , it is not an
24 admission by Bank of America. The settlement
25 agreement itself , which is Exhibit 15 to Morgan

1 Stanley's opening brief, states that Bank of
2 America, quote, unquote, acknowledges the facts set
3 forth in the statement of facts. It doesn't say
4 anything about an admission.

5 Second of all, Your Honor, the
6 statement of facts doesn't reflect any conclusive
7 finding of fact by any of the government entities
8 or parties to the agreement. Again, the settlement
9 agreement in Paragraph 21 C states that the
10 settlement was being made, quote, without any
11 adjudication or finding of any issue of fact or
12 law.

13 So that's just by way of context,
14 Your Honor. And the bases for our motion for
15 excluding the settlement agreement are twofold.
16 First, it's not relevant. And second, it's
17 prejudicial.

18 So first on relevance, Your Honor.
19 As you heard, the settlement is being offered by
20 the FDIC in order to support a criticism of
21 Dr. James's analysis, and specifically a criticism
22 that the control group could use to compare to
23 loans at issue in this case is not clean, if you
24 will.

25 The FDIC is incorrect. As I said,

1 first of all , the way in which they're using this
2 settlement is inappropriate because , again, it's
3 not an admission and it's not any finding of fact.
4 A settlement is just that , a settlement of disputed
5 claims by two parties .

6 THE COURT: Uh-huh.

7 MR. BURNOVSKI: And unproven
8 allegations of misconduct are irrelevant in
9 addition to being hearsay, Your Honor . Second, in
10 any event , the settlement doesn't support Dr.
11 Snow's criticism . The portion --

12 THE COURT: Doctor?

13 MR. BURNOVSKI: I'm sorry. Dr. Snow
14 is the FDIC's rebuttal expert to Dr. James. And
15 the criticism of Dr. James is being offered through
16 Dr. Snow.

17 And the portion of the statement of
18 facts that the FDIC is relying on is a statement
19 that says -- and it's just one small portion of the
20 statement of facts , which includes a number of
21 other issues that are completely irrelevant to this
22 case, and neither the FDIC contends otherwise .

23 And the portion the y're focusing on
24 is a supposed admission -- which, again, we don't
25 believe is an admission -- that Countrywide or that

1 Bank of America as the successor to Countrywide
2 sold loans to the GSEs Fannie and Freddie, and t hat
3 many of those loans were, quote, defective and/or
4 otherwise ineligible for sale to the GSEs.

5 But what that says, Your Honor, it's
6 important to sort of focus on what that means. The
7 fact that loans were in eligible for sale to the
8 GSEs may be a problem for Bank of America , but it
9 doesn't pose any problem for Dr. James's control
10 group. And that 's because -- simply because the
11 loans didn't meet the underwriting standard s for
12 the GSEs and were ineligible -- were, therefore ,
13 ineligible for sale to the GSEs is completely
14 irrelevant in this case.

15 Because the offering documents for
16 the securities at issue in this case specifically
17 disclose that the loans in this case we re
18 underwritten pursuant to standards that were
19 different from the GSEs underwriting standards and,
20 in fact , were, quote, less stringent than the GSEs
21 underwriting standards. S o, therefore , Your Honor ,
22 it simply doesn't prove what they're trying to
23 prove with the settlement.

24 Second of all , even if there was
25 some, quote, unquote, defective loans in the --

1 that were sold to the GSEs, again, that doesn't
2 show that there's anything wrong with the
3 benchmark.

4 For example, Your Honor, if the GSEs
5 requested that -- as part of their post purchase
6 diligence efforts that the loans be a repurchase by
7 Countrywide and the loans were, in fact,
8 repurchased, they would n't have been included in
9 Dr. James' benchmark because he simply excluded any
10 loans that would be repurchased.

11 Second of all, Your Honor -- so that,
12 Your Honor, is in a nutshell why we believe the
13 settlement agreement and the statement of facts are
14 irrelevant.

15 But second of all, it's also highly
16 prejudicial. The FDIC's argument is that it can't
17 be prejudicial because Morgan Stanley was not a
18 party to the settlement agreement. But that's not
19 true, Your Honor.

20 The same concerns regarding juror
21 confusion and unfair prejudice that an imate legions
22 of decisions that exclude settle ment agreements are
23 similarly present here.

24 For example, a juror may hear about a
25 10-billion-dollar settle ment with the U.S.

1 Government over conduct relating to RMBS that
2 overlaps substantially with the allegations here
3 and they simply assume that , Well, Morgan Stanley
4 must have done the same thing because all Wall
5 Street banks are the same .

6 Second of all , such an improper and
7 unfounded inference will be particularly
8 prejudicial here because , as I mentioned, Bank of
9 America itself didn't admit any wrongdoing under
10 that settlement agreement.

11 Moreover, the fact that there are no
12 conclusive findings of fact in the statement of
13 facts is important because the jury is likely to
14 find that just because a settlement is with some
15 government entities , it would take on undue
16 significance in the minds of jurors.

17 And compounding that , Your Honor , is
18 the fact that the settlement agreement itself
19 references a separate settlement over claims that
20 the FDIC brought against Bank of America on behalf
21 of various failed banks , including Franklin Bank.

22 And I'm sure Your Honor can imagine
23 the confusion and prejudice that would result from
24 knowing that Bank of America has settled a
25 billion-dollar claim that is very similar to the

1 claim at issue here. Or settled for a billion
2 dollars with similar claims to those at issue here.

3 Now, the FDIC offer s to redact -- in
4 a footnote, offers to redact references to the FDIC
5 in the agreement. But, Your Honor, for the reasons
6 I've articulated, Morgan Stanley doesn't believe
7 that that even begins to address the prejudicial
8 effect of admitting the settlement agreement.
9 Particularly given its limited, if any, relevant
10 probative effect.

11 THE COURT: Would you elaborate on
12 the -- you think they're offering it for the truth
13 or they're offering it to show something other than
14 the truth of the matter asserted therein?

15 MR. BURNOVSKI: I believe they're
16 absolutely offering it for the truth, Your Honor.
17 It has no relevance unless you accept as true the
18 statement in the statement of facts that
19 Countrywide and/or Bank of America sold, quote,
20 unquote, defective loans to the GSEs. Only if you
21 accept that as true is it at all relevant in this
22 case.

23 THE COURT: And so setting aside the
24 settlement agreement, this evidence exists
25 elsewhere? The evidence that they're trying to

1 show, does that exist outside of the settlement
2 agreement?

3 MR. HOLTON: Affirmative evidence of
4 defects in the comparative set, Your Honor, I don't
5 believe that we have any other evidence of that.

6 THE COURT: So how would you -- okay.
7 So that if I exclude this document, you're saying,
8 then you don't have that argument to make?

9 MR. HOLTON: Well, our expert, Dr.
10 Snow, points out in his rebuttal that Dr. James,
11 their expert, makes no effort to demonstrate that
12 his control set is, in fact, free of defect. So
13 that argument is there. And I don't think they're
14 contesting that Dr. Snow can make that point, which
15 he will make and made in his expert report.

16 But the next step here that we think
17 is critically important to demonstrating just how
18 flawed this analysis is, and you've heard from
19 before how important this issue can be, this loss
20 causation issue, how flawed this analysis is, he
21 said yes. I don't know. Acknowledgment,
22 admission, statement of facts, findings of fact, it
23 all sounds a little bit like, you know, dancing on
24 the head of a pin, Your Honor.

25 Countrywide or Bank of America

1 acknowledged that they did this. And they
2 acknowledged not just that the loans were not
3 consistent with the guidelines of the GSEs, but
4 that they were defective . So it's a little bit of
5 a misread to say -- to read it as narrowly as
6 Counsel has.

7 As far as the prejudice goes , Your
8 Honor, really, truly, the important part of this is
9 Countrywide 's acknowledge ment. We can present that
10 in a way that would eliminate any reference to a
11 settlement agreement --

12 THE COURT: How long is that section ?
13 Is it not just a paragraph?

14 MR. HOLTON: It's very short . It's
15 two paragraphs , Your Honor . It's two paragraphs .
16 And we certainly could distill that and offer that
17 acknowledgment, admission, whatever you want to
18 call it, to the jury without the context . We don't
19 think this is necessary without the context of the
20 settlement agreement and the 10 -million-dollar
21 settlement that Bank of America entered into and
22 all the rest of it.

23 So if the prejudice that they're
24 talking about is something that concerns Your
25 Honor, I think it could easily be remedied while

1 still allowing us to put in what's really the crux
2 of the evidence that we want to put in from the
3 agreement , which is the acknowledge ment, admission
4 by Countrywide that it sold defective loans . The
5 biggest seller of loans to the GSEs during the
6 relevant time period , that it sold defective loans
7 to the GSEs.

8 And opposing counsel is , of course,
9 free to make argument s to the jury about why that
10 evidence should be not credited or ignored , but
11 that's really, I think , all that his arguments
12 really go to aside from the prejudice issue. So we
13 think that evidence certainly should be
14 specifically admitted.

15 (Sotto voce discussion between
16 counsel)

17 MR. HOLTON: So my learned colleague
18 has reminded me that it's really not hearsay , Your
19 Honor , because what we're doing is demonstrating
20 that there was an investigation that their expert
21 should have done and didn't do to try to
22 demonstrate that he should have seen that these
23 loans -- that this acknowledge ment by Countrywide
24 had done something to investigate that before
25 putting this before a jury and before the Court and

1 saying, I've got a clean control group over here of
2 loans.

3 Not only did he fail but he had
4 reason to think that there was a problem and he
5 didn't do anything about it. So it's not for the
6 purpose of necessarily for the truth of the matter
7 being asserted. I t's that it's another example of
8 a faulty process that Dr. James went through to
9 identify the control led set of loans that he
10 purports to identify as being clean of defect.

11 If Your Honor has any questions , I'm
12 of course happy to answer them .

13 MR. BURNOVSKI: A nd couple of points
14 in response, Your Honor.

15 THE COURT: Sure . Real quick .

16 MR. BURNOVSKI: S ure. Just take them
17 in the reverse order. The last point that
18 Mr. Holton made that it's not being offered for the
19 truth of the matter , I respectfully disagree . It
20 absolutely is . And they're fr ee to cross-examine
21 Dr. James without having to rely on the settlement
22 agreement.

23 THE COURT: I'm not going to get hung
24 up on the hearsay part because experts routinely
25 can and do rely on hearsay .

1 MR. BURNOVSKI: Okay. Then, Your
2 Honor, still the initial point Mr. Holton made is
3 that this is necessary in order to show that there
4 was a process failure by Dr. James. Again, they
5 don't each rely on irrelevant and prejudicial
6 evidence to do so. They note that it can be
7 redacted to just those two paragraphs.

8 I'm not sure as a practical matter
9 how that could possibly work, Your Honor, given
10 that the very fact of a settlement with the
11 government is prejudicial. Whether or not the
12 findings in that are characterized as an admission
13 or as an acknowledgement of a finding as legal
14 significance --

15 THE COURT: Let me interrupt. Can I
16 see that page, please? I just want to see what it
17 looks like.

18 MR. HOLTON: Of course, Your Honor.
19 I must say that I have -- here --

20 MS. SESHENS: We have a clean --

21 MR. HOLTON: You have a clean copy.
22 Okay.

23 MS. SESHENS: Your Honor, we have a
24 clean copy for you.

25 MR. HOLTON: I didn't want to give

1 you one with my notes on it.

2 THE COURT: Well , you did want to
3 give me the one with your notes on it , but you
4 thought it's not fair.

5 (Laughing)

6 MR. HOLTON: I didn't think it was
7 appropriate to do so , Judge. It's just a couple of
8 brackets , actually . So do you -- here -- okay .
9 Fine.

10 THE COURT: Off the record for a
11 second while all the cross talk.

12 (Discussion off the record)

13 THE COURT: Go ahead .

14 MR. BURNOVSKI: I just wanted to make
15 a point. Your Honor 's mentioned that you're not
16 going to get hung up on hearsay because experts
17 rely on hearsay all the time . And while true , that
18 doesn't mean that the evidence should be admitted
19 into the record . I just wanted to quickly draw
20 that distinction. Thank you.

21 THE COURT: That is a fair point that
22 in and of itself it doesn't -- well, let's see , if
23 he relied on it. Well, that's a discovery issue.
24 That's a fair point as to whether it actually comes
25 into evidence , but whether he can refer to it or

1 talk about it as the basis of his opinion --

2 MR. BURNOVSKI: Understood, Your
3 Honor. I just wanted to draw that distinction.

4 THE COURT: That's fair.

5 (The Court reviewing documents)

6 THE COURT: I'm looking for the
7 beginning here where it says the statement of
8 facts -- hold on one second.

9 MR. BURNOVSKI: Your Honor, may I
10 approach? Well, it might be helpful to have the
11 settlement agreement as well as the annex together ,
12 if that's what Your Honor was --

13 THE COURT: Sure . If you've got it,
14 I'll take a look at it. Go ahead. Come on up.

15 MR. BURNOVSKI: This is the
16 settlement agreement, Your Honor. And this is the
17 complete annex and the relevant page it's on, Page
18 27.

19 THE COURT: Let me ask you a
20 question. It says statement of facts and there's a
21 settlement agreement. What is the evidence or how
22 does one know that this is , in fact , true as
23 opposed to -- or an admission by Countrywide , for
24 example , as opposed to just a finding by -- by who,
25 by the what , the DOJ or SEC or somebody like that?

1 MR. HOLTON: I think that the
2 Department of Justice was the principal negotiator.
3 Your Honor, again, I think -- I don't have it in
4 front of me, but I think the settlement agreement
5 explicitly notes Countrywide's acknowledgement of
6 the statement of facts. And that was a semantic
7 discussion that we had had previously.

8 I'm not sure where in the agreement
9 that is. I would have to take a look at it if I
10 could try to find it. But Your Honor --

11 MR. BURNOVSKI: Your Honor, it's --
12 recital I of the settlement agreement is the
13 portion that talks about Bank of America
14 acknowledging and not admitting the statement --
15 the statements in the statement of fact. And I
16 would add as well, Paragraph 21 C, contrary to what
17 Mr. Holton just said, indicates explicitly that
18 there is no finding of fact.

19 THE COURT: Then what does it mean to
20 acknowledge the facts set out in the statement of
21 facts in English?

22 MR. BURNOVSKI: I think, Your Honor
23 -- I'm sure that provision was heavily negotiated.
24 And I think the fact that it's not an admission is
25 meaningful and it's more than just a semantic

1 meaning . And obviously I don't mean to not answer
2 Your Honor's question .

3 THE COURT: No. I --

4 MR. BURNOVSKI: We weren't involved
5 in that settlement agreement and I'm not sure what
6 it is. But the fact that it -- I know what it's
7 not, and it's not an admission. And I would add to
8 that again the fact that there is expressly no
9 finding of fact --

10 THE COURT: Yeah .

11 MR. BURNOVSKI: -- by the government.

12 THE COURT: I mean, it could have
13 said they have read the statement of facts. It
14 also could have said they admit or adopt the
15 statement of facts. I tend to agree with you that
16 it was not something done lightly.

17 COURT'S RULING

18 THE COURT: All right . I'm going to
19 rule that pursuant to 403 , the danger of undue
20 prejudice greatly outweighs the probative value of
21 this document. And I will exclude the document
22 itself. If the evidence -- the information may
23 very well be pertinent to the expert's analysis and
24 opinions , but you'll have to get at it another way.

25 MR. HOLTON: Yes, sir.

1 THE COURT: Very good. We'll leave
2 it there. Are we scheduled to resume this at some
3 point in the future?

4 MS. SESHENS: Not presently, but I
5 was just going to ask Your Honor if maybe you
6 wouldn't like to, but I suppose we probably have
7 to.

8 THE COURT: Yeah. No. I would be happy
9 to. Is 2017 good for you?

10 (Laughing)

11 THE COURT: Let's see. We're set for
12 trial at the very beginning of January , no? Or right
13 after July --

14 MR. YETTER: July . July.

15 MR. CALLAHAN: July 6th.

16 (Multiple speakers)

17 THE COURT: Yes, the beginning of July
18 -- right after the 4th of July.

19 MS. SESHENS: Correct.

20 THE COURT: I'm sure we could find some
21 time between now and then to set aside a day to work
22 on these things . And then I guess we'll have to --
23 whatever we can't finish , we'll have to pick up -- you
24 know, as the trial starts , spend a day or two ,
25 hopefully not more than that , on pretrial matters.

1 All right. I guess let me just let you
2 talk to Veronica. Veronica and I will visit the next
3 day or so. And if you then would follow up with her
4 and see what works with your schedules. And if we can
5 squeeze in a day between now and the beginning of
6 trial -- before that week of trial, I could do that.

7 I'm going to be gone the week of -- from
8 Saturday through the following week. So that leaves
9 us with the second half of June. We ought to be able
10 to find some time in there at some point. I know I've
11 got a couple of trials scheduled, but we'll do the
12 best we can.

13 MR. YETTER: Thank you, Judge. That
14 works.

15 THE COURT: Okay.

16 MS. SESHENS: Thank you, Your Honor.
17 Before we adjourn, I had promised Your Honor some
18 cites on materiality. I just wanted to respond to
19 Your Honor's prior question. And we cite two cases on
20 Page 22 of our opposition on the Dr. James Motion in
21 Limine. There are In re Merck and In re SLM Corp.
22 Securities Litigation. And both are on the same page
23 at the bottom of 22.

24 THE COURT: And that's under your
25 opposition on?

1 MS. SESHENS: The Dr. James -- the
2 challenge to Dr. James's materiality opinion as
3 improper hindsight coming in. Your Honor had asked me
4 previously for case s and I said I didn't have other s
5 at the ready, but we pulled them together.

6 THE COURT: But you had also cited --
7 you had told me about Burlington on that topic and
8 Gebhardt .

9 MS. SESHENS: I did. I just wanted to
10 make sure Your Honor had plenty to read.

11 THE COURT: Thank you. Burlington and
12 Gebhardt. Very good. We'll leave it there . Have a
13 nice afternoon.

14 MS. SESHENS: Thank you very much, Your
15 Honor.

16 THE COURT: Can I get some order s to
17 conform with the rulings I have made thus far , please?

18 MR. YETTER: Yes, Your Honor.

19 MS. SESHENS: Absolutely.

20 MR. YETTER: We'll get those over to
21 you.

22 THE COURT: If you-all can share it and
23 have it all be one order thus far , I would appreciate
24 that.

25 MR. YETTER: We'll do that, Judge.

26

1 THE STATE OF TEXAS)

2 COUNTY OF HARRIS)

3 I, Carolyn Ruiz Coronado, Official Court Reporter
4 in and for the 151st Civil District Court of Harris
County, State of Texas, do hereby certify that the
5 above and foregoing contains a true and correct
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6 proceedings requested in writing by counsel for the
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7 cause, all of which occurred in open court or in
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